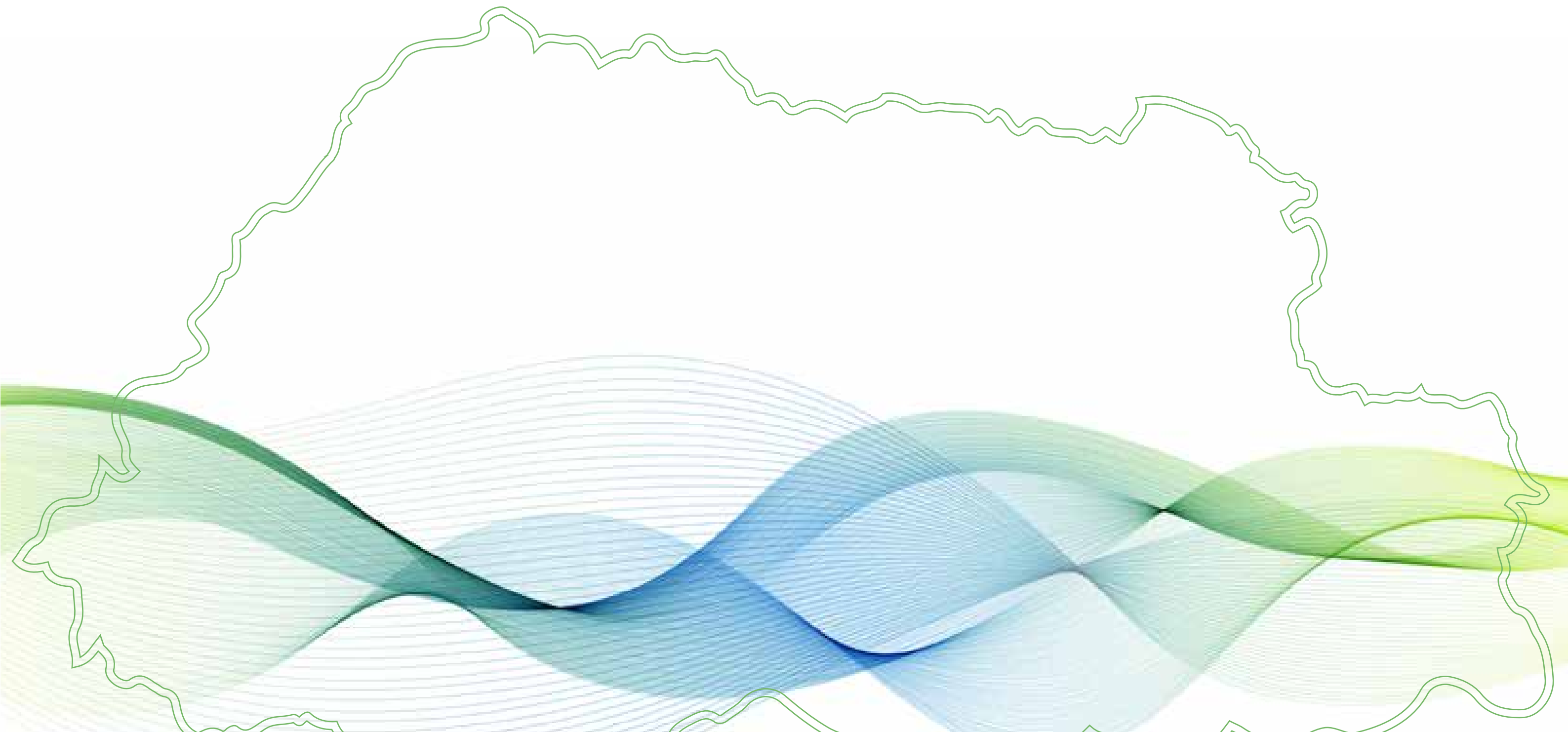
NFIC NATIONAL FINANCIAL INCLUSION COLLABORATION

In-pursuit of an Inclusive, Innovative and Resilient Economic Development through Collaborative Engagements

The Current State of Financial Inclusion in Bhutan and the Way Forward



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March 2022

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TABLE OF CONTENTS

Introduction – About Financial Inclusion

The Alliance for Financial Inclusion (AFI) describes the concepts of financial inclusion in terms of access, usage and quality. Access pertains to making the financial services available and affordable to users; usage entails making customers use the financial services frequently and regularly; and quality means making financial services tailored to clients' needs. Ample amounts of research studies have revealed that financial inclusions are associated with many potential developmental benefits especially from the use of digital financial services such as mobile money services, payment cards, and other financial technology (fintech) applications.

A study cited by the World Bank states that a study in Kenya found that access to mobile money services delivered huge benefits, especially for women since it enabled women-headed households to increase their savings by more than a fifth and hence, help reduce extreme poverty among women-headed households by 22 percent. Further, the digital financial services can not only reduce cost of receiving payments but also help manage financial risks by making it easier for people in trouble to collect money from distant friends and relatives. Another benefit of financial inclusion is the ability to help people accumulate savings and increase spending on necessities with saving accounts, especially free saving accounts. The power of technology has helped in expanding access to and use of accounts as well as transformed the payments landscape.

According to a survey report by the World Bank, over 52 percent of adults have sent or received digital payments globally in 2017 compared to 42 percent in 2014. Similarly, a study on "Bank adoption of mobile banking: stakeholder perspective" by Mullan, Bradley and Loan in 2017 found that banks are also adopting mobile banking at a faster rate owing to the global mobile phone penetration, competitive advantage, customer convenience, strategic importance, customer demand, low perceived risks and stakeholder partnerships. Furthermore, a study in Uganda in 2021 also found "significant and positive mediating role of cultural norms in the relationship between mobile money adoption and usage financial inclusion of MSMEs".

The World Bank and its associates consider financial inclusion as a key enabler to reduce extreme poverty and boost shared prosperity. As a result, since 2010, over 55 countries have made commitments to financial inclusion and more than 60 countries have either launched or are developing a national financial inclusion strategy according to the World Bank. In addition, financial inclusion has also been identified as an enabler for seven of the 17 Sustainable Development Goals. Accordingly, Bhutan has also set her goals and strives to achieve an overarching ambitious target of 85 percent financial inclusion by 2023 from the baseline of 64 percent in 2017. The Royal Monetary Authority (RMA), as the central bank, is leading the financial inclusion movement in Bhutan with the formation of the Financial Inclusion Secretariat and initiating numerous programs and regulatory changes to foster financial inclusion, financial literacy and financial capability.

Importance of Financial Inclusion

The World Bank views financial inclusion as a building block for both poverty reduction and creating opportunities for economic growth, and can be further reinforced with access to digital financial services which is critical to join the new digital economy. Although financial inclusion facilitates day-to-day living, the latest Findex data show that close to one-third of adults, about 1.7 billion are still unbanked. The data further indicates that about half of the unbanked people are women from poor households in rural areas or out of the workforce.

Furthermore, financial inclusion not only facilitates day-to-day living, and helps individuals and businesses plan for everything from long-term goals to unexpected emergencies but also enables the use of other financial services such as savings, insurance, invest in education or health as well as learn about managing risk. However, according to the World Bank report, majority of the adults without an account cite a lack of money as a key reason indicating the unaffordability of the financial services to the low-income users. Other reasons for not having an account also include distance from the financial service providers, lack of necessary documentation papers and lack of trust in financial service providers.

Financial inclusion strengthens the availability of economic resources and builds the concept of savings among the underprivileged populace. Owing to the importance of financial inclusion in empowering the disadvantaged section of the society, almost all nations are taking initiatives to expand access points, make financial services more affordable and create conducive regulatory environment to enable access to transaction account. The service providers and regulators need to not only make the services available and affordable but also need to strengthen consumer protection regulations as well as diversify financial products and providers to bring new players into the sector and increase access to financial services. Therefore, financial inclusion is a major step towards inclusive growth.

Financial Inclusion in Some Selected Economies

Developed Economies

The United Kingdom is credited to be one of the first nations to realize the importance of financial inclusion with the publication of its strategy of financial inclusion “Promoting Financial Inclusion” in 2004. The government not only took active part in the process of promoting financial inclusion but also set up a Financial Inclusion Fund of 120 million pounds as well as launched a Financial Inclusion Taskforce in 2005 to monitor the progress on financial inclusion and make suitable recommendations. The government also identified the need for financial literacy and basic understanding of financial concepts as critical success factors to ensure increased financial inclusion, and worked with potential service providers to develop proposals for delivering free face-to-face money advice in areas of high financial exclusion. Similarly, in other developed economies like Sweden, Belgium and France, legislations prevent banks from denying intending customers to open account. There are also legislations requiring banks to open minimum number of branches in the rural areas.

Emerging Economies: OECD and India

The financial exclusion rate in the OECD countries ranges from 8 percent (in high income countries) to 49 percent in Central Asia and Eastern Europe to 58 percent in South Asia and 65 percent in

Latin America. Owing to the wider gaps, attempts have been made to promote access to financial services via microfinance network and provision of conducive environment and regulations.

In India, the Reserve Bank of India (RBI) said that the financial inclusion index increased by 24% between 2017 and 2021 according to their FI-Index. The financial inclusion is also said to have got a boost during the COVID-19 pandemic due to the increased usage of digital platform by small merchants and peer-to-peer payments. Even before the biggest driver of financial inclusion, Pradhan Mantri Jan Dhan Yojana (PMJDY) in 2014, facilities such as "no frill" accounts and "General Credit Cards" for low deposits and credits were introduced by the RBI to achieve greater financial inclusion.

Africa

In the African continent, a large portion of the population resort to the use of informal financial services as they are financially excluded. However, the M-PESA (M for "mobile" and PESA, Swahili word for "cash money"), a mobile money service from Kenya is an example of how consumer access to financial services can be revolutionized using technology. According to Orabank, the current financial inclusion rate in Africa is about 60 percent. For example, in Nigeria, both the government and the regulatory authorities have started activities to promote financial inclusion since 2005. A critical initiative was the incorporation of financial inclusion as one of the cardinal objectives of the Nigerian Financial System in 2020.

Current Status of Financial Inclusion

As per 2020 Financial Inclusion Status report, there are five banks, three insurance companies, one CSI bank, five microfinance institutions, one pension institution, two telecom companies and one stock exchange in Bhutan. These are key players in the financial inclusion of any country's populace because they directly or indirectly foster financial inclusion. Financial institutions like the banks, insurance companies and stock markets are the primary players while the telecom companies are the enablers of financial inclusion. Furthermore, the Financial Inclusion Status of Bhutan, 2020, states that 76.08 percent of Bhutanese have a savings account while only 21.79 percent have access to loans.

Looking back at the Bhutan Living Standard Survey (BLSS) 2017, about 77 percent of the households have saving accounts and about 28 percent of the households use debit/credit/ATM cards while one-fifth (21.3 percent) of the households do not use any banking products. It is also noteworthy that there is a significant difference in the use of banking services between the urban (about 95 percent) and rural (about 67 percent) households. About 40 percent of the total households in Bhutan have loans with bank loans being the most common source of funds. However, loans from other institutions such as NPPF, RICBL/BIL and REDCL are minimal at 4 percent. Furthermore, only a lower proportion of the rural households (33 percent) have bank loans as compared to their urban counterparts at 42 percent.

Knowing the importance and significance of financial inclusion to the economy of Bhutan, the RMA initiated numerous policy and infrastructure reforms. Some of such initiatives are the establishment of the Financial Inclusion Secretariat, development of National Financial Inclusion Strategy (NFIS), National Financial Literacy Strategy (NFLS), Financial Inclusion National Action Plan (FINAP) 2019-2023, Priority Sector Lending, and many more. On the infrastructure front, the alternative delivery channels such as ATM, POS and Agents increased in terms of number of access points as well as per 10,000 adults.

Pertaining to the financial inclusion, one of the most important steps taken by Bhutan in general and the RMA in particular is the formulation of the National Financial Inclusion Strategy (NFIS 2018 – 2023). The NFIS is expected to promote financial inclusion based on the four pillars: 1) appropriate financial products and services; 2) financial accessibility and proximity; 3) financing for economic growth; and 4) financial literacy and consumer protection. The main objective of the NFIS is to achieve financial inclusion of the mass since financial inclusion has the potential to achieve Bhutan's national goal of sustainable and inclusive socio-economic growth. On the flip side, Bhutan has also been performing poorly in terms of financial access among the rural population in international benchmarks compared to other developing countries. The difference between the rural and urban populations is evident even from the Bhutan Living Standard Surveys.

Since 2018, the RMA has also started the publication of "State of Financial Inclusion (SOFI)" with the main objective to inform and provide pertinent information pertaining to financial inclusion in Bhutan highlighting the key areas such as financial access points, financial inclusion value store transaction accounts, regulatory initiatives and financial literacy programs. As per the report, the financial access points in Bhutan have improved over the years with agents and POS growing faster than the traditional bank branches. The report emphasized on four areas: access to financial services; usage of financial services; expanding sources of finance; and reforms and regulations as explained hereunder.

Access to financial services

One of the most important components of financial inclusion is the development of infrastructure to enhance financial accessibility. Access points play pivotal roles in enhancing financial inclusion by facilitating and easing transaction costs, improving accessibility and making financial services more affordable. According to the SOFI 2020, the overall number of access points have increased from 2018 to 2020, especially the alternative delivery channels such as ATM, POS and Agents. In addition, mobile banking and e-wallet users are also increasing significantly. One of the main factors behind increasing mobile banking is the Bhutan QR Code that got boosted by the current pandemic of COVID-19. Since its launch in July 2020, Bhutan QR Code has taken exponential growth. Similar to the Bhutan QR code, the e-money users have also increased significantly owing to the national lockdowns due to COVID-19 pandemic. However, a point to be noted is the number of shareholders. Only about 12 percent of the total eligible populace own shares.

Usage of financial services

The main purpose of granting access to financial services is to enable the usage of financial services for their various benefits. Knowing the importance of access and usage, the World Bank and other institutions consider having an account as an important indicator of financial inclusion. Having account with formal banking or financial institutions provide a safe way to store money and build savings for the future, and make it easier to pay bills, access credits, make purchases, and send or receive remittances. The SOFI 2020 stated that there are 76.08 percent of the adult Bhutanese population with a bank account in one of the formal financial institutions including micro-finance institutions. Compared to 2019, the year 2020 saw an increase in saving account holding, availing credit and subscribing to insurance policies.

Expanding sources of finance

One of the pillars of the NFIS is to expand the sources of finance and the RMA has taken various initiatives as the Central Bank of Bhutan. One of such initiatives is the launch of the Priority Sector Lending (PSL) in 2017 to catalyse the cottage and small industry (CSI) sector by provide better access to finance and also to increase youth employment as well as to promote domestic production for import substitution. As of 2020, 533 projects were approved under this scheme and 479.70 million Ngultrums worth of loans were sanctioned to the approved projects. To further enhance the sources of finance, the RMA also initiated the JABCHOR platform, which enables entrepreneurs to raise equity financing and grow into successful ventures with the support of legally executed business partnership deeds as per the laws of the country. Every year entrepreneurs are selected to pitch their business ideas to raise equity.

Another avenue to expand the sources of finance is the launch of the Bhutan Crowdfunding platform developed by the Royal Securities Exchange of Bhutan (RSEBL) licensed under the Crowdfunding Regulations issued by the RMA. The main objective of the Bhutan Crowdfunding platform is to provide an alternative financing model to raise funds from the general public for Start-ups, new business ventures and the CSIs in Bhutan. The crowdfunding platform provides a win-win position for both the entrepreneurs and the general public by providing fund raising opportunity to the former and investment avenue to the latter.

Reforms and regulations

The last domain to gauge the state of financial inclusion according to SOFI 2020 is the reforms and regulations as the emergence of disruptive technologies, such as Application Programming Interfaces (API), Artificial Intelligence (AI), Big Data, Distributed Ledger and Block Chain are transforming the financial sector landscape. Thus, to respond to and keep up with the rapidly emerging technologies, the RMA introduced the Regulatory Sandbox (RS) Framework to provide the requisite regulatory guidance, to increase efficiency, manage risks and create new opportunities for consumers. The RS will enable the firms and innovators to successfully test their solution with a well-defined space and duration before a wider-scale launch by carefully monitoring and containing the risks.

Impediments to Financial Inclusion

According to the World Bank Findex Report 2017, each economy has its own successes, challenges and opportunities when it comes to financial inclusion. Similarly, Bhutan also has its own share of difficulties. First of all, only 76.08 percent of eligible Bhutanese have savings account. Furthermore, only about 67 percent of the rural population have savings account as opposed to about 95 percent in the urban areas. As per the AFI Bhutan report, Bhutan strives to achieve a target of 85 percent financial inclusion by 2023 from 64 percent in 2017. However, some of the foreseeable hurdles to achieving the mentioned financial inclusion are the low level of financial literacy, especially in the rural areas, scattered population and lack of infrastructure and enabling regulations that increase the operational cost of financial services.

The latest adult literacy rate according to the National Statistics Bureau (NSB) of Bhutan is 66.6 percent. Most of the rural populace are either illiterate or semi-literate so the generic financial products and services cannot be enforced on them. There is a lack of specialized financial institution that could cater to the rural populace as well as people with certain disabilities. As a result, although a savings account could be created with the help of banks or bank officials, the usage or the benefit of such accounts will be very low. Due to such difficulties, the rural population will be either underserved or unserved hampering the financial inclusion goals. Thus, financial literacy should be a top priority in order to empower all the citizens to be able to use the modern financial services, especially the digital financial products and services. The other challenges such as the scattered population and lack of infrastructure are also difficult to solve because they increase the operational costs of the financial institutions with minimal returns.

Impediments and Solutions

IMPEDIAMENTS

GEOGRAPHICAL DISTANCES

Only about 67 percent of the rural population have savings account as opposed to about 95 percent in the urban areas.

LACK OF FINANCIAL LITERACY

Most of the rural populace are either illiterate or semi-literate so the generic financial products and services cannot be enforced on them

HIGH TRANSACTION COSTS

High transactions fees for basic financial services to cover the high operational cost of financial services especially for rural and low-income people

SOLUTIONS

BRANCHLESS BANKING

Offer banking services through agents or mobile apps where opening a branch is not feasible.

FINANCIAL EDUCATION

Financial literacy programs should be a top priority in order to empower all the citizens to be able to use the modern financial services, especially the digital financial products and services

AFFORDABLE FINANCIAL SERVICES

Make the basic financial services fees affordable

The Way Forward

Compared to the Global Findex of 2017 by the World Bank and the SOFI 2020, a lot has happened in few years especially with the onset of the current pandemic of COVID-19. Even before that, the latest global economic and financial crisis of 2007-2008 concerted efforts around the globe towards fortifying the financial systems and financial markets. One of the measures that emerged to strengthen the financial sector is financial inclusion as increased financial inclusion is believed to expand the capacity of the financial markets and thus, make it able to withstand any local, regional or global economic shocks. Hence, the way forward for improving financial inclusion is to institute systematic approach which could align roles and responsibilities with institutions and develop frameworks to guarantee continuity, sustainability and efficiency.

Role of the Government

One of the most important stakeholders in improving financial inclusion is the government as the changes in plans and polices are dependent on the government. The government can create an enabling environment for the financial operators and the consumers to relate and interact in a mutually beneficial way. An inclusive growth with the help of financial inclusion and financial literacy is vital. Studies have proven that financial inclusion and financial literacy will eventually lead to financial capability, thus empowering the disadvantaged section of the population to contribute to the economic growth of the nation through better financial management.

In addition, the government can follow the best practices of the developed economies such as maintaining financial inclusion and literacy records in order to cater to their needs better. For example, neither the Findex data seem to include the Findex data of Bhutan nor there is a database in Bhutan to measure financial inclusion index. Although the NFIS and the SOFI documents mentioned the financial inclusion of 64 percent in 2017, the result may not be directly comparable to the international Findex as there are no detailed information available pertaining to the financial inclusion computation. Thus, the government can look into improving the database of the process and progress of the status of financial inclusion so that better targeted services can be rendered by the relevant stakeholders to improve the overall financial inclusion of the country.

Role of RMA

"Financial Inclusion efforts have been prioritized at the national level with the joint support from the key government agencies and financial service providers. The RMA has taken several measures to diversify and enhance financial inclusion towards strategic economic development", mentioned Dasho Penjor, the RMA Governor, in the Forward section of the SOFI 2020 report. This is evident that the RMA as the regulatory body is taking the initiative to improve and increase the financial inclusion of the excluded populace via various means and avenues. Nonetheless, it would be noteworthy that financial literacy and consumer protection are the foundation to stir financial inclusion in the right way.

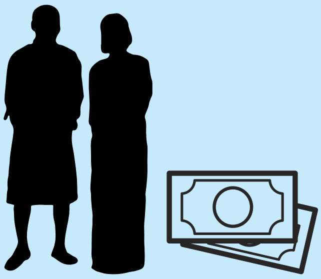
Many studies and credible financial institutions have also mentioned that financial literacy and consumer protection would ensure that the users of the financial services are not unduly exposed to extortion and abuses. It is proven that improved financial literacy among the consumers and a strong consumer protection system reduces distortions in the market information available to consumers, and thus, consequently lead to healthy competition, increased transparency and improved access in retail financial markets. However, on the consumer protection front, a Financial Consumer Protection Survey (a pilot study), a recent study conducted by the Gedu College of Business Studies showed an overall consumer protection index of 3.90 (or 78 percent) indicated a room for improvement.

Thus, the RMA as the regulatory body needs to actively engage in cross-cutting initiatives, ranging from information campaigns such as creation of virtual webs; inclusion of financial literacy programs in school curriculum and training of school teachers; to constant consultations with the private partners and financial institutions. The Financial Inclusion Secretariat department of the RMA can invest heavily in research programs to help improve financial education and protection. The RMA can also continue with its current noble initiatives of setting-up and owning of the financial inclusion strategy documents and implementation of the reforms, regulations and the promotion of microfinance institutions and activities that promote rural finance in the country.

Bhutan Financial Inclusion Target

23.92% unbanked as of FIS Report 2020

Achieve 100% banked with Financial Inclusion Strategies



UNBANKED

- Rely on cash
- Doesn't have basic bank account
- Doesn't have access (restricted access) to financial services

STAKEHOLDERS

- Banks
- Insurance Companies
- Microfinance Institutions
- Telecom Companies
- Postal Networks
- Financial Cooperatives
- Government

BANKED

- Have a transaction account
- Use broad range of financial services

FINANCIAL INCLUSION STRATEGIES

- Broader Inclusion
- Customer-centered product innovation
- Financial Capability
- Strong Consumer Protection
- Better financial infrastructure
- More and interoperable access points
- Enabling legal and regulatory frameworks
- Public and private sector commitment
- Open and balanced playing field

Conclusion

The improvement of financial inclusion is pertinent in a developing nation like Bhutan because there is global consensus that financial inclusion not only brings integrity and stability into any economy's financial system but also plays important role in fighting poverty in a sustainable manner. The review of various documents and publications indicated that the RMA is advocating financial inclusion and financial literacy as these are deemed to be an engine for driving an inclusive economic growth.

Nevertheless, striving to achieve greater financial inclusion is hampered by economic activities, geographical region and segments of the society that do not have access to financial services, financial assistance and financial information with ease and at a minimum cost. In order to overcome such hurdles and promote a balanced growth, policy makers need to realize that there is no single pre-determined recipe for improving financial inclusion, and developing country policy makers are in the best position to evaluate their unique institutional, socio-economic, financial and political circumstances and pursue the strategy that best fits the given situation.

Accordingly, the government, regulatory authorities and financial institutions have taken measures and framed policies to promote financial inclusion. The mobile phone penetration and the current pandemic of COVID-19 seem to have catapulted use of mobile and internet banking. Taking advantage of such circumstances and focusing on mobile phone penetration can foster economic growth by facilitating financial inclusion as well as consolidating the impact of financial inclusion on economic growth.

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