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Democratizing Financial Services: Financial Inclusion as an Enabler of Sustainable Peace and Development in Uganda

Augustine Bahemuka[1*] and Elias O. Opongo[2]

[1]Alumni, Hekima Institute of Peace Studies & International Relations – Nairobi, Kenya
[2]Director, Centre for Research, Training & Publications, Hekima Institute of Peace Studies & International Relations – Nairobi, Kenya

*Corresponding author: augustine.bahemuka@hekima.ac.ke

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ABSTRACT

Democratization of financial services through digital technology has significantly evolved Uganda's financial sector, which has subsequently invigorated more academic and policy enthusiasm for financial inclusion. Socio-economic inequalities, such as disproportionate access to employment, quality education, proper healthcare and housing construct structural barriers that reinforce financial exclusion; and can gravitate into deep grievances, consequently causing social conflict. Therefore, addressing the barriers of financial inclusion alleviates the likelihood of protest from lower segments of society, hence creating more peaceful and socially stable communities.

Keywords: Financial inclusion, democratization, horizontal inequalities, social conflicts, Uganda

The critical role of the financial sector in enhancing efforts to alleviate poverty and promote sustainable development has been amplified in the last two decades, which consequently renewed the enthusiasm to innovate practical solutions of increasing access to formal financial services (FFS). Globally, 2.5 billion adults were financially excluded in 2011, that's to say, 51% of adult population was unbanked[1]. The significance of account ownership in financial inclusion is two-fold. One, it is a fundamental indicator in determining levels of financial inclusion and in addition, it empowers people to access and use financial services in a way that facilitates development[2]. This prompted World Bank Group to commission the vision of achieving universal financial access by 2020. Indeed, account ownership grew to 76% by 2021, where developing countries constituted more than half of this banked population while adoption of mobile money emerged as the major driver of account ownership in Sub-Saharan Africa.[3] South Africa and Kenya have the highest proportions of financially included people in Africa given that 89% and 75% of their adult populations, respectively, can access formal financial services[4]. In Uganda, there has been a great improvement in financial inclusion: Out of the overall adult population of 14.4 million, 78% are financially included; however, uptake of formal financial services is 58% (10.8 million) which is almost squared off by informal financial services at 56% (10.3 million)[5]. The key difference between formal and informal financial services is that the former are provided by regulated or

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supervised financial institutions, such as banks, micro-finance institutions, Savings and Credit Cooperatives Organisations (SACCOs) whereas the latter are offered by unregulated providers, such as village groups, and Rotating Savings and Credit Associations (RSCAs).

Democratization of financial services essentially refers to the process of widening the scope of the population that can access and utilize formal financial services at affordable costs and higher efficiency. Digitization is the main driver of this transformative journey, which has eased access to financial services, such as payments, insurance, credit and savings; which, for instance, can be accessed on mobile phones. The underlining objective of democratizing financial services is to drive inclusivity by extending formal services to low-income earners and vulnerable people, including women, poor households, rural communities and refugees; with the ultimate goal of invigorating their economic confidence.[6] In this sense, financial inclusion and democratization of financial services are considered as synonymous concepts. Financial inclusion has attracted different definitions, which are seemingly divergent in their emphasis on accessibility and usage vis-a-vis quality of financial services. Mandira Sarma (2008)[7] defines financial inclusion from the perspective of building an inclusive financial system: "It is a process that ensures the ease of access, availability and usage of the formal financial system for all members of an economy." However, this paper argues for a wider and multi-dimensional understanding of the concept of financial inclusion, which considers other critical categories, such as frequency of usage of services; extent to which services meet client expectations and impact on their lives.[8] This approach is as equally critical of the quality of financial services and products as their access and usage; and seeks to ensure that services are designed and tailored to meet specific needs of the lower social spectra; which subsequently uplifts their lives and livelihoods. The landmark Rangarajan Committee report (2008) in India defined financial inclusion as "the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost."[9] The emphasis on the timing and affordability of the financial services is significant as it insinuates the sense of urgency and priority to enable vulnerable groups optimize available opportunities. The Bank of Uganda (BoU) defines financial inclusion as accessibility and usage of a broad range of quality and affordable financial services which enhance one's financial security.[10] The end goal of financial inclusion, according to Bank of Uganda, transcends high figures of account ownership or high volumes of people who are making transfers and accessing loans. It is ultimately about poverty alleviation and enhancing the economic security of households through usage of affordable financial services.[11]

Nair and Tankan (2015) further highlight three key elements to be considered when defining financial inclusion: (a) extending financial services to segments of society that are economically excluded; (b) deepening of financial services for segments of the population whose accessibility is restricted or minimized by various factors; and (c) ensuring greater financial literacy and consumer protection to guide those who can access financial services in making appropriate choices.[12] One, financial exclusion arises from a myriad of factors, including unemployment, illiteracy, poverty, remoteness from trading zones, conflict-mediated displacement, among others. These situations are exacerbated when people in this segment do not even possess the specific means that facilitate financial access, such as identification documents to guarantee account ownership; and mobile phones to access digital financial services. Money is a critical enabler of financial inclusion because it facilitates transportation and even funding of accounts. For instance, one study assessed the use of mobile money usage among 5,478 micro-entrepreneurs in Uganda and revealed that 86% owned mobile money accounts; yet only 49% actively used the account.[13] This trend was also observed in the Indian government's ambitious plan to pool unbanked and underbanked segments of the population into cycles of formal financial services: An estimated 70 million accounts were opened within the first two months; yet only 20 million were actively transacting[14]. The implication herein is that inasmuch as account ownership is key enabler of formal financial inclusion, it may not necessarily guarantee so, depending on the levels of financial capability. Remote areas in rural villages are usually characterized by poor transport and communication infrastructure, which consequently repulses potential investment and development.

Two, financial deepening with focus on addressing the factors that hinder inclusivity of financial services correlates to the dimension of financial inclusion that probes the quality of services. In other words, people in this social segment probably have access to financial services, however, are hindered from optimally enjoying their full potential, which consequently compromises the efficiency of services. Such structural barriers include cultural norms and gender discrimination against women, lack of collateral to access credit and lack of capital to start businesses, which affects young micro-entrepreneurs, *etc*. For instance, a study carried out to assess financial inclusion among women in Nairobi, Kenya revealed that by the nature of their work, which constitutes both domestic and business roles, women are more time-constrained than men; hence are more likely to embrace mobile money vis-à-vis bank services.[15] Such instances create potential business opportunities for formal financial service providers (FSP) including, banks and microfinance institutions, to widen their agency banking networks.

Three, financial literacy, which in many cases correlates with low education levels, is cited as one of the critical variables of financial inclusion.[16] One study which investigated financial inclusion barriers in Uganda revealed that low levels of education exposed women to financial exclusion more than their male counterparts.[17] Another survey reported that over 70% of Uganda's adult population have not attained secondary school education, which could imply low levels of financial literacy.[18] Education is important because it empowers learners with the ability to, among other things, comprehend and make more informed financial decisions. In fact, one study provided evidence that financial literacy improves levels of financial inclusion since people gain deeper appreciation of the available financial services; hence making better choices.[19] The Rangarajan Committee report (2008) categorically emphasized the significance of "understanding financial products and services"[20], which also vividly instigates human agency on the end-users' part. The financial health of the lower social segments of the population is another fundamental aspect for consideration in equal measure, because it raises concerns over plausible ill-effects such as over indebtedness of customers.[21] This concept of addresses people's resilience - ability to withstand and recover from financial shocks – and the capacity to pursue means of meeting their life goals.[22] In other words, it is imperative to protect the consumers of financial products and services, especially vulnerable groups from debt traps and exploitation tendencies by some service providers.

Financial inclusion is also perceived from the broader aspect of social inclusion, which aims at reducing the gap between the proletariat and bourgeoisie by promoting equality and equity of all people, especially those living on the periphery of society.[23] It is actually a critical condition for addressing socio-economic inequalities in the society[24], such as unequal access to education and healthcare facilities, and employment opportunities; which notoriously impoverish people in the lower social segment. Addressing socio-economic inequalities, henceforth, implies alleviating the structural barriers of financial inclusion thereby increasing the opportunities of vulnerable people to access financial services and ultimately improve their livelihoods. This backdrop informs the assumption upon which this paper is based that financial exclusion of masses limits their capacity of economic empowerment to create progressive, peaceful and socially stable communities; and can breed social conflict.[25]

This paper is divided into four sections. The following section presents Frances Stewart's theory of *Horizontal Inequalities* which shows how socio-economic inequalities can mutate into flashes of conflict. The next section presents structural barriers of financial inclusion; after which the paper demonstrates how digital innovation has been used to address some of the structures of financial exclusion. The last section concludes the paper and suggests some policy recommendations.

Theoretical framework: Horizontal Inequalities

The theory of Horizontal Inequalities (HI) is based on the premise that when differences in cultural status coincide with economic and political differences between groups, this can mutate into deep grievances that may instigate social unrest.[26] This theory is authored by Frances Stewart, from her research investigating why there is conflict in some multi-ethnic and multi-religious countries whereas others are peaceful. From her observations of high incidences of war and conflict among countries whose history was characterized by marked poor performance in economic growth, food production and human indicators, such as quality education and proper healthcare[27], the author drew the hypothesis that presence of major HIs creates volatile situations which can gravitate into conflict. Horizontal inequalities essentially exist among groups that share cultural identity – ethnic, religious, national or racial; and have economic, social, political and cultural status dimensions. Stewart's hypothesis has a two-fold implication on the literature on conflict: on one hand, ethnic or religious differences are at the heart of the conflict problem; and on the other, cultural differences are superficial and just instrumentalised; but rather it is economic factors (or social) that account for the root causes of conflict.[28] Economic HIs include inequalities in ownership of assets and access to natural resources and employment opportunities; whereas social HIs include inequalities in access to means of meeting basic services, such as proper healthcare, quality education, and safe housing. Group inequality provides powerful grievances which leaders can use to mobilise the masses into political protest, by calling on cultural markers (shared history or language or religion) and pointing to group exploitation.[29] This paper applies the *Horizontal Inequalities* theory to demonstrate how socio-economic inequalities, which also create structures of financial exclusion, can cause grievances which are instrumental for group mobilization into conflict.

Structural barriers of financial inclusion

In the discourse of financial inclusion, data on the factors that affect inclusivity of financial services are traditionally categorized into the supply-side and demand-side whose main point of divergence lies in their focal perspectives. The former focus on the initiatives of financial service providers; whereas the latter are skewed towards needs and expectations of end-users, which consequently create structures that prevent and/or restrict vulnerable people from optimally using financial services. These include: lack of identification documents, gender disparity and cultural norms, financial capability and remote geographical areas.

(a) Lack of identification documents

The official identification document required for account ownership in Uganda is the National Identification card (hereafter National ID). However, since the official issuance of National IDs in 2014, the National Identification and Registration Authority (NIRA), which is the official body mandated to issue identification documents in Uganda, has encountered various drawbacks, including delays in processing and issuance of National IDs, breakdown of systems and printing infrastructure, corruption and bribery, long queues. These issues have consequently compromised service delivery and efficiency of the body.[30] This has excluded millions of Ugandans, especially the youth, from embracing formal financial services in banks and micro-finance institutions; and owning mobile money accounts whose gateway is a sim-card which requires the identification card for registration. It is estimated that as at September 2022, NIRA had only registered 25.9 million Ugandans; and the number of those unregistered was 17.4 million.[31] The youth comprise the highest number of unregistered Ugandans, even when they constitute 75% of the population. This partly accounts for the reasons why young people are one of the most financially excluded segment.[32] The identification card is an instrumental tool for one to meet the eligibility criteria for account ownership because it facilitates the Know Your Customer (KYC) policies and procedures of financial institutions, as mandated by their respective regulators. The KYC document essentially guides financial service providers (FSP) to carry out due diligence on their customers with two-fold objectives: To prevent illegitimate use of financial services through criminal activities such as anti-money laundering and terrorism financing; and to get in-depth understanding of customers, which enables FSP to tailor products and services to customer needs and expectations.[33] However, given the high proportion of unregistered people and others with lost or misplaced National IDs, the identification card becomes a tool of exclusion from accessing financial services.

(b) Gendered discrimination and cultural norms

The *FinScope Uganda Survey* (2018) stresses the instrumental role played by digital technology in driving the financial inclusion agenda among the unbanked and underbanked segments of the population. Account ownership is more skewed towards mobile money because the eligibility criteria is less formal and complex than for financial institutions; and it is more accessible.[34] Even more, there is evidence of gendered disparity in Uganda where 9.7 million adults (58% men and 46% women) own mobile phones; whereas 1.9 million adults (13% men and 8% women) can access mobile data to facilitate internet connectivity.[35] The survey further reveals that uptake of informal financial services, such as social groups, and Rotating Savings and Credit Associations (ROSCA) is more skewed towards women.[36] These finding are tantamount to another study that attributes the vivid disparities in financial inclusion between men and women to gender-based discrimination, among other factors, which restricts their participation in economic activities.[37] Cultural norms have also contributed to the low uptake of formal financial services among women. In Nairobi, for instance, women are more likely to own mobile money accounts because of their domestic obligations, which does not give them ample time to meet the formal procedures followed to open bank accounts.[38] With such factors in hindsight, efforts to trickle down the positive impact of financial inclusion to the lower spectra of society are greatly derailed.

(c) Remote geographical locations

Local communities living in rural areas that are hard to reach have been associated with low levels of financial inclusion. This is attributed to the poor infrastructure that characterizes such areas, which consequently makes rural villages less attractive to potential investors, including financial service providers. The *FinScope Uganda Survey* notes that rural areas are undesirable to FSP because they are identified with poor people whose meagre transaction volumes and financial values will not generate as much revenue in profit.[39] It is such factors that deepen the levels of financial exclusion of marginalized groups of people living in rural villages. However, in addressing socio-economical inequalities, financial service providers should not only focus on the economic efficiency, but also be cognizant of their moral duty to uplift the livelihoods of all segments of people.[40]

Breaking structural barriers of financial inclusion through digitization

This section presents three innovations that have accelerated the agenda of democratizing financial services. The common denominator shared across is "digitization", which is the main engine driving financial inclusion. The necessity of digitizing financial services was further accelerated by the Covid-19 pandemic, which brought about restrictions in movement. Inasmuch as digitization has not completely broken the structural drivers of financial exclusion in Uganda, it has gained significant mileage in increasing the number of people who can access financial services, such as account ownership, loans, mobile banking and mobile money; and agency banking. However, underlying factors including poverty and illiteracy regress the agenda of inclusivity. This section presents some of the financial services that have become more accessible and available to people in Uganda through digitization; and the limiting factors affecting their efficiency.

(a) Account ownership

Account ownership is a fundamental gateway to financial inclusion as it serves as a conduit for making payments, sending and receiving money, and savings. Accounts can be opened with banks and other regulated financial institutions or mobile money service providers. Traditionally, account opening consists of formal brick-and-motor processes and procedures which require a given level of literacy for one to comprehend. This includes filling out forms, multiple signatures, capturing biometrics, etc. The physical requirement for one to own an account excludes many people due to the poor branch networks of banks, especially in rural settings and complexity of the process which deterred many people from account ownership. However, account ownership has been digitized by some financial service providers in Uganda, by providing self-service platforms where underbanked and underserved people can onboard themselves. For instance, one can own an account instantly with Equity Bank[41] using a mobile phone. The long-term impact of this initiative cannot be understated from both supply and demand sides. As financial service providers, digital account ownership increases the landscape of accessibility to their products; hence more customers and revenue generated whereas for the unbanked, it presents an opportunity for embracing formal financing. However, customers who open digital accounts have transaction limits, and require to have registered for the National ID. Financial capability is another limitation of digital accounts whereby not all people who eventually open accounts have the ability to fund them; which raises concern over account ownership as an indicator of financial inclusion.

(b) Mobile Money

Mobile money is by far the most widespread formal financial service in Uganda, which has high stakes of bridging the gaps in financial service accessibility, especially among financially excluded rural communities.[42] This can be attributed to the level of customer satisfaction associated with the service: It is accessible, convenient, requires less effort; and user-friendly for numeric-literate uneducated people. The *FinScope Uganda Survey* report (2018) estimated that 56% (10.4 million) of the adult population has access to mobile money services; however, only 43% (7.9 million) is actually registered for the service.[43] This indicates that majority of Ugandans are financially included through mobile money inasmuch as some access services though family members or friends. Mobile money was commissioned in 2009 when Mobile Network Operators (MNO) partnered with financial institutions; and has registered a gradual growth in customer base from 21.1 million to 34.4 million in 2015 and 2022[44], respectively. It facilitates various financial services, including sending and receiving money, payments of goods and services, and savings. It is widely used as a medium of exchange, but also serves as a preferred store of value for low-income earners[45] who are unable to own bank accounts. Consumers can also access quick unsecured loans using their mobile money accounts to meet their immediate needs; boost their businesses and also cushion their families from financial shocks, such as health emergencies. Mobile loans usually have a 30-days repayment period and limits which depend on borrowers' credit worthiness. The limiting factors affecting optimal usage of mobile money include financial capability – as the cost incurred on transaction charges is returned to consumers – and fraud risk, which has greatly compromised trust and confidence in digital services. One study estimated that only 40% of the population that has prior access formal financial services can be reached by mobile money, which implies exclusion of a significant group of which women and the vulnerable are overrepresented.[46] Inasmuch as mobile money has not fully addressed the structural drivers of gendered financial inequalities, it has uplifted a significant proportion of women into the spectrum of formal financing.[47]

(c) Agency banking

In 2016, the Financial Institutions Act 2004 was amended to provide for agency banking. This banking model permits supervised financial institutions to enter into a contract with a third party (referred to as Agent), who must be approved by Bank of Uganda (BOU), to provide authorized services on behalf of the institution.[48] The underlying principle of this banking model is extension of formal financial services closer to the local communities particularly, the unbanked population which has two-fold benefits: It reduces operational costs incurred by the bank in running branches whereas to the local population, financial services are brought into close proximity. The *Uganda National Household Survey 2016/17* revealed that 33% of male and female household heads across several districts relied on piggy banks as their saving mechanism[49], which not only exposes them to the risk of financial loss through fire or natural calamity, but also lose opportunities of accessing credit facilities against their savings. Agency banking becomes the best alternative of extending formal financial services to such unbanked and underbanked groups of people, who may probably be unable to access bank branches due to long distances. The financial services provided by Agents include deposits and withdraws, direct transfers, account opening and bill payments. Indubitably, agency banking demystified the traditional banking model, which required physical presence in the banking hall. This initiative also offers employment opportunities as business handlers who operate the agent points. However, there is need for adequate financial literacy to deepen people's understanding about agency banking operations so that they can make more financially sound decisions.

In this section, we have explored the common innovations that have made it possible for people in the lower social spectra to access digital financial services with more ease, convenience and at considerably affordable rates; thereby overriding the structures driving financial inequalities. For instance, young people who cannot own accounts because of delayed issuance of their National ID after registration can use their National Identification Numbers (NIN) to open digital bank accounts to facilitate their businesses, albeit the inconvenience of transaction limits. Even more, micro-entrepreneurs and women in rural and low-income urban settings can use their mobile money accounts to access unsecured loans to operate their businesses. The most notorious limitations of financial inclusion are financial capability and financial literacy.[50] Accessibility to digital financial services necessitates a mobile phone and ability to meet transaction costs, as the bare minimum; and ability to comprehend the available products and services in order to appreciate their benefits and hence make sound choices.[51] Inasmuch as innovation has not fully addressed socio-economic inequalities that reinforce financial exclusion, there is credible evidence that it can drive this agenda to greater mileage, with support of inclusive economic policy frameworks.

CONCLUSION

This paper sought to establish a relationship between democratization of financial services, through financial inclusion, and sustainable peace. We noted that there are various definitions of financial inclusion; most of which are drawn from the perspective of social exclusion of groups of people living at the periphery of society. Social exclusion of a certain group who, for instance, share cultural identity is caused by socio-economic inequalities, such as disproportionate access to natural resources, employment and business opportunities, quality education and proper healthcare, which if combined with group cultural differences consequently create structures that reinforce financial exclusion. Therefore, addressing the structural barriers of financial inclusion is tantamount to eliminating the financial inequalities that socially exclude vulnerable people in society; hence eliminating chances of group mobilization into conflict by politicians. According to Stewart (2005), group inequalities can be exploited by politicians to instigate social unrest to drive their own agenda. Therefore, addressing the socio-economic inequalities that cause social exclusion consequently reduces financial exclusion and builds sustainable peace. Financial inclusion builds a solid foundation of inclusive economic development of the under privileged in society, especially in rural and low-income urban settings. By engaging in local trade, people become part of economic clusters, the consolidation of which has positive impact on the local economic systems, hence promoting inclusive development.[52]

FOOT NOTES

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