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Access to financial services: The case of the 'Mzansi' account in South Africa

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Abstract

The presence of rationing of financial services in the developing countries is a major obstacle to achieving sustainable growth. In recent years there have been co-ordinated efforts to increase the level of financial inclusion, i.e. to reduce the supply-side constraints restricting access to finance. This paper aims to understand household's latent behaviour decision making in accessing financial services, by analysing an entry level Mzansi account in South Africa. The willingness to access financial services is not taken as given, but it is instead defined by perceptions and attitudes. The Mzansi intervention is appealing to individuals with basic but insufficient financial education. Aspirations seem to be very influential in revealing the choice of financial services and to this end, Mzansi is perceived as a pre-entry account not meeting the aspirations of individuals aiming to climb up the financial services ladder.
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1. Introduction

The issues of financial and economic development have been a focus of substantial theoretical and empirical literature. Although there is some controversy over the direction of causality in the finance-growth relationship, financial systems are important for facilitating and maintaining economic growth. Furthermore, financial development is generally accepted to exert beneficial effects not only on growth but also in terms of poverty alleviation (see e.g. Beck et al., 2009). The latter further emphasises the importance of finance in relation to development, particularly when the very nature and functions of financial systems existing in Western economies and implicitly embedded in existing theoretical models become an inadmissible assumption. Traditionally empirical studies investigating the financial development relationship to growth have focused on financial depth. This fact conforms to an implicit assumption of universality and to some extent, uniformity of financial systems in terms of their functions. Focusing on financial depth essentially assumes all financial systems work in the same way (i.e. possess the same functions) and the overall (growth inducing) impact is simply a measure of magnitude, a magnitude that can be directly related to a measure of the development of the relevant financial systems. More recently analytical attention has turned to the issues of financial outreach and inclusion; something often referred to as access to finance. This is an important conceptual shift with far-reaching consequences.

The lack of access to finance in developing economies could, nevertheless, be an equilibrium outcome resulting from imperfect market competition. In terms of credit provision, the relevant theoretical models are the ones explaining credit rationing. The implicit assumption of credit to a source for expansion of economic activity and therefore, growth has, to some extent, biased analytical attention towards credit, but many of the underlying arguments in such models can be readily extended to provision

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of other financial services. Such a one-sided focus in the theoretical literature is, nevertheless, understandable bearing in mind that credit has important consumption smoothing function (and hence can lead to better outcomes in a dynamic context).

In the access to finance discourse, we are concerned with "type 2" rationing in the sense of Stiglitz and Weiss (1981) where some applicants are refused loans altogether despite their willingness to pay the market rate of interest. There are two defining characteristics of this theoretical reasoning that transpire in most empirical studies related to access to finance. The first relates to that the (latent) demand for credit (or general financial services) is taken for given. The other, which to some degree follows from the former, is the focus at the supply side.

Let us briefly review the type two credit rationing. There are two main sources of this type of rationing, namely hidden action and hidden (project) type. Hidden action means that the effort to ascertain the project risk is either too costly, or the project risks itself is non-verifiable. The former entails the classical transaction cost argument: banks incur similar screening costs, and thus they will prefer lending larger credits. In such cases, a credit rationing equilibrium may arise, because any increases in the loans create moral hazard effects (in the case of hidden action) and adverse selection (in the case of hidden type). At a macroeconomic level, these negative effects dominate the effect on the interest rate change and by reducing the profitability of the banks make it impossible for them to attract sufficient finance via deposits. Note that from lenders' point of view, the hidden action problem arises because there is not sufficient information about the potential clients. Therefore, the lack of studies about the potential demand contributes to this exclusion, since it prevents lenders from ascertaining the nature of the demand and thus the lack of such information creates a hidden action problem. Of course, research on the determinants of the latent demand for financial services in its own cannot eliminate the problem since the transaction cost argument will still hold.

Bester (1985) showed that in hidden types model by posting collateral borrowers can achieve a separating equilibrium with no credit rationing. The extent to which this can be achieved, depends, of course, on the relative availability of collateral. Whenever the net worth of such is low, this separation may still be unachievable (Stiglitz and Weiss, 1981). Given that in a typical type of cases of lacking access to finance one is likely to consider in a developing country, the availability of any type of collateral has to be excluded from the very outset, why do we even invoke such an argument? Note, however, that the same line of reasoning could be applied to any form of 'third party collateral' i.e. when a third party provides collateral that eliminates the hidden type of problem. If one assumes that the demand is present, it would be logical for the lenders to jointly provide such 'third party collateral' in expanding the provision of financial services. Such an intervention could be beneficial for the lenders if the suppressed demand is existing in that the individual risks faced by lenders will essentially be pooled together into a common insurance-like pool, and the aggregate benefits would exceed the individual lenders' costs. It is, nevertheless, important to stress that if the latent demand that we just assumed is not there, or it is not as strong as assumed, the above logic breaks down. Therefore, studies of this demand are also necessary if a coordinated intervention designed to overcome the hidden type problem is being considered. Implementing such a coordinated intervention could prove unsustainable whenever this latent demand is weak. Nevertheless, there is another theoretical argument in favour of such an intervention. As De Meza and Webb (2006) show credit rationing implies an infinite marginal cost of credit to the borrower. A stylised fact of the poor in a development context, however, is their high-risk aversion. Under high and extreme risk aversion, the marginal cost of credit will reduce, which says that in such circumstances, the existence of demand becomes very suspect. One could nonetheless, hypothesise that one of the drivers for such high-risk aversion is the exclusion from formal financial services itself, which forces poor households to avail to alternative risk coping strategies. This suggests that introducing coordinate intervention can by providing access to financial services reduce risk aversion and therefore, via increased marginal cost (for these) ultimately create demand. This solicits studying demand under such interventions.

The strategies, from a client point of view, to eliminate rationing discussed in the theoretical models include reducing the size of the project, postponing its start and saving (to self finance larger part of the project). Reducing the size of the project assumes it is divisible, which may or may not be the case. Since most 'projects' involving poor 'micro-entrepreneurs' would be rather small, size reduction will have limited scope. Postponement, on the other hand, will only work if it does not have been deteriorating effects on the projects net value. Note that one may combine these strategies, and such combinations may overcome the credit rationing problem. We will argue that whenever characteristics that facilitate the above strategies, such as e.g. propensity to save and interest in longer-term financial planning are present within the poor, these indicate the presence of latent demand.

The general implication of the Stiglitz-Weiss model is that if banks have a way to distinguish between different classes of risk, rationing will reduce and disappear. The theoretical suggestions of how to reduce and eliminate credit rationing (e.g. Bester, 1985; Besanko and Thakor, 1987; Chan and Thakor, 1987; Parker, 2000; Lensink and Sterken, 2002) are essentially proposing different means to achieve this. Note, however, that the informal market can be typically viewed as a substitute for not well functioning formal markets (in the presence of rationing) and hence should incorporate some of these rationing avoidance means. Note, for example, that informal markets are highly segmented. The conventional wisdom views this as a way to prevent arbitrage possibilities (and hence an imperfection). Imposing segmentation can, however, also be seen as a type of discrimination among different types of clients, which achieves a separating equilibrium under conditions of initial rationing. In simple words, the credit rationing is a type of pooling equilibrium, where all clients get the same conditions), while separating equilibria provide means for distinguishing different clients. Whether the latter arises from a clients' actions (such as providing extra collateral or savings) or by a supply-side initiative (such as intentional market segmentation), the outcome is qualitatively the same.

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