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Purposeful capital: how can financial services support inclusive growth?

Inclusive growth requires long-term investment in people, places and industries. How can financial services business models be transformed?

Starting with the broad picture and the "big guys" - financial institutions - angle. There is a legitimate question of how much and what kind of contributions towards more inclusive growth we can (or should) expect from the financial industry. I have 3 remarks:

1. Let us not forget how expensive financial and banking crises are. They destabilise the economy, have impact on fiscal policy and obviously affect people (taxpayers and bankers alike). In my view, substantial or even the largest proportion of the final cost of a crisis is in the end borne by the poorest or by the middle class. Most people on the upper side of the income distribution ladder are affected much less (if at all).
2. We must minimise risks of crises in future. We now have better regulation, better supervision and more transparency. We must not undermine but rather utilize these advantages, and ensure that rules are properly implemented and enforced.
   This leads me to question, whether the financial industry, notably banks, are or are not well fitted to significantly contribute to "social policy" or to safeguard better inclusion. It can be argued that the industry should primarily do, what it is set to do - taking deposits from surplus savers and lending them to those who can turn them into profitable investments, all this in a cheap and efficient way. And in doing so, to keep risk under control.
3. Obviously, I am very pleased that many financial institutions have started considering broader goals than just a short-term profit, and that they deal to some extent with social issues (e.g Erste Social Banking) or accept responsibility for promoting long-term objectives (e.g. Blackrock shareholders responsibility). I hope they will lead by example, yet the logic of business is different in these cases. Risk and costs are important variable, which stand against many transaction or activities that one could consider positive for inclusive growth in the world of financial services. Sometimes, the "economically rational cost" is rather high (when talking about small transactions) or the risk is high (lack of capital on borrower's side)

Let me now turn towards the other side - clients, or better say people - and take an important step from figures to people's stories and faiths. I would like to set the scene for what broad problems people around the globe have to deal with. And please accept my apology for my narrow angle caused by my European origins, even though post-communist and being still poorer part of Europe compared to the west.

A would first like to highlight four topics and I will address them later in my contribution:

1. (***Non-)availability of basic financial services***: that is excluding the possibility for people to participate on current, efficient and much more than local economy (buying and selling goods and services)
2. ***Complexity of financial products***: risk of making serious mistakes by clients (has impact especially on people with lower experience and lower education)
3. ***High cost of services and availability of/accessibility to credit:*** issue of higher relative price for smaller transactions and its impact, even in case of objective risk pricing, on people with lower income, lower education or other form of "disadvantage"

4. ***Dealing with incidents:*** access to courts, possibility to defend against wrong doing or even way how to solve insolvency

To reach improvement in any of these areas, it requires in my view an intelligent, efficient, market compliant involvement of governments or/ and non-profit sector (including donors), to achieve improvements:

1. ***Basic financial services should be available to all***: smart regulation should play key role
    a. Initiate legislative action, if necessary (for example, if financial sector includes some client)
    b. Existing and new legislation needs to be intelligent (= adequate), safe and well enforced; proper enforcement is key and most difficult to achieve (especially in less developed country).
    c. Create incentives for financial services providers to decrease cost for low-income clients, also provide incentive for use of services (for example support or introduce on non cash payment by government)
    d. Allow or even promote non-bank payments (in same cases this could be even more important than banking service)

2. ***Complexity of financial products, informational asymmetry***: partly via education, partly adequate regulation
    a. Financial education of clients - essential condition for many people to enjoy benefits from use of financial services
    b. Solid consumer protection introduced by legislation, and its thorough enforcement - balance, clear rules, that would rather than leading to disputes encourage financial industry to provide adequate quality services to clients

    The two measure above are key to improve informational asymmetry and ensure clients have competence, to take good, well informed, decisions.

3. ***High cost of services and availability of/ accessibility to credit*** - need for governance to step in, preferable "market consistent way"
    a. High costs: low-income clients are not attractive for financial institutions. Economically speaking, higher cost is justified (small balances, no revenues from cross-sale). Politicians need to take the decision, if market goals or social goals prevail (in case of basic services like "banking account for everyone").
    b. Availability of credit: credit for low-income clients usually means lending very small amounts to higher-risk clients - this is either not available or too expensive. My preference is using (public) credit enhancement that would reduce this problem. It could be guarantees to compensate for (otherwise justified) high cost of risk, interest rate subsidy for small loans etc. This is a role for development banks. Rules need to be well designed, transparent, efficient and based on risk sharing (whenever possible).

4. ***Dealing with accidents*** - good legislation, education, etc.
    a. We will always face the situation, where certain income groups and people with lower education will face issues when wanting or needing to borrow money. There can be "misselling" or just people taking wrong decision, when confronted with possibility to borrow money.

b. In the Czech Republic, hundreds thousands of people face executions. With population being 10 million inhabitant, rather large part of the society is affected both economically and socially.
c. Generally speaking - In order to boost of investments, countries often improve creditor rights and the result is as above (people in executions can stop activity and decide to be "excluded", while the financial industry often, to increase "sale", "over sale" to such a clients (to make things worse)
d. Introduction of lender liability can help, if it is balances and tackles mostly "misselling" and is not promoting moral hazard on side of borrowers. This should be combined with financial education and access to support of people "in need".
e. There should be possibility of personal bankruptcies, even though conditions are strict. Moral hazard is justification of strict approach. The major question is - where is the right balance - and I do not think we (for example) are not there yet. Perhaps the OECD can help as a forum to share experience and best practices across the OECD member countries to gradually eliminate financial exclusion.