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# Theories of financial inclusion

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## Abstract

This article presents several theories of financial inclusion. Financial inclusion is defined as the availability of, and the ease of access to, basic formal financial services to all members of the population. Financial inclusion means that individuals and businesses have access to useful and affordable formal financial services that meet their needs in a responsible and sustainable way. Financial inclusion practices vary from country to country, and there is need to identify the underlying principles that explain the observed variation in financial inclusion practices. These set of principles are called theories. Financial inclusion theories are explanations for observed financial inclusion practices. This study shows that the ideas and perspectives on financial inclusion can be grouped into theories to facilitate meaningful discussions in the literature. The identified theories of financial inclusion are the public good theory, dissatisfaction theory, vulnerable group theory, systems theory, community echelon theory, public service theory, special agent theory, collaborative intervention theory, financial literacy theory, private money theory, public money theory and the intervention fund theory. The financial inclusion theories identified in this paper are useful to researchers, academics, policy makers and practitioners. The resulting contribution to theory development is useful to the problem-solving process in the global financial inclusion agenda.

**Keywords:** financial inclusion, theory, financial access, access to finance, dissatisfaction theory, vulnerable group, systems theory, community echelon, public service, special agent, financial literacy, collaborative intervention, intervention fund, households.

**JEL Code:** G00, G21, O16.

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## 1. Introduction

I seize this occasion to break the silence among those of us that have observed the recent trend in financial inclusion practice, particularly the cross-country differences in financial inclusion practice, and are worried that the modern trend in financial inclusion practice lacks an underlying theory or a set of guiding principles that can help to improve our understanding of financial inclusion as a pro-development initiative in the economics and finance discipline. As new academics emerge and are eager to understand financial inclusion in a fast changing world where sophisticated financial innovations have increased rapidly in the formal financial sector, it is needful to remind ourselves that the financial inclusion literature may become porous and disconnected if there are no set of coherent theories to prescribe some general principles that explain financial inclusion practice.

Today, there are many studies on financial inclusion and I am immensely thrilled by the interesting findings in the financial inclusion literature (Demirguc-Kunt et al, 2017). But the notable lack of synergy between the policy and academic literatures on financial inclusion (Prabhakar, 2019), and the neglect of theory in explaining real-world financial inclusion practices is worrisome. Currently, there are no elaborate theories of financial inclusion in the policy or academic literature.

My first response to this realization was to ignore it, hoping that some good might come of it. But it is difficult to ignore the lack of theory, because in the financial inclusion literature, ideas have become texts, and opinions have become stylized facts in the literature. In fact, proponents of financial inclusion do not challenge the recent financial innovations and programs used to achieve financial inclusion objectives because they do not want to be seen as being anti-innovation or anti-development.

I have heard colleagues in top policy-making institutions make statements like “we don’t need a theory of financial inclusion”. Some feel that “building a theory of financial inclusion is a waste of time”. Others think that “theorizing financial inclusion would lead to lack of relevance to practitioners and policymakers”. The general conception is that it is better to focus on the accumulation of evidence on financial inclusion than concentrating on building theories of financial inclusion, and even when some financial inclusion theories emerge, there will be contentions about what is a theory and what is not a theory, whether we should have a single unifying theory of financial inclusion or multiple theories of financial inclusion, whether we should rely on old or new theories, and there will be arguments about the degree of abstraction embedded in old and new theories. Despite the disagreement over the value of theory in the financial inclusion discourse, we can at least agree that we need a framework or a set of principles to help us understand what financial inclusion is, how it is achieved and who benefits from financial inclusion programs. These principles are called theories.

In this paper, I present several theories of financial inclusion that are useful to academics, practitioners and policy makers. These theories are divided into three broad categories, namely, theories of financial inclusion beneficiaries, theories of financial inclusion funding, and theories of financial inclusion delivery. Of course, no theory is perfect and I have been careful to reduce the degree of abstraction in the theories in order to increase the relevance of these theories to both academics, practitioners and policymakers. Each of the theories discussed in this paper can be expanded into large volumes of texts to take into account a wide range of philosophical dimensions and critical perspectives of each theory but, due to

space constraints, I have presented an abridged and concise version of each of the theories and I would gladly welcome any requests to expand each of the theories to be published as a single theoretical paper. I hope the reader would find the theories useful for intellectual discourse for future research in financial inclusion. While the aim of the paper is not to critique studies that lack theoretical perspectives, I will make reference to such studies for illustration purposes.

This paper contributes to the financial inclusion literature. By articulating a general theory or theories of financial inclusion, I present a new and comprehensive statement of what the financial inclusion enterprise should be about. I argue that the financial inclusion literature - whether academic or policy – can use theories to provide believable explanations for financial inclusion objectives and outcomes. Policy makers can also use these theories to justify the various strategies they adopt in achieving financial inclusion in their countries.

The remainder of the paper is organized as follows. Section 2 presents some foundations for financial inclusion. Section 3 discuss the theories that explain who benefits from financial inclusion. Section 4 discuss the theory of financial inclusion delivery. Section 5 discuss the theories on financial inclusion funding. Section 6 suggests ways to apply the theories of financial inclusion to data. Section 7 concludes.

## **2. Some foundations**

### **2.1. Defining financial inclusion**

Financial inclusion is the provision of, and access to, financial services to all members of population particularly the poor and the other excluded members of the population (Ozili, 2018). Financial inclusion can also be defined as the delivery of banking services at an affordable cost to the vast sections of the disadvantaged and low-income groups (Dev, 2006). Financial inclusion is also defined as the use of, and access to, formal financial services (Sahay et al, 2015). These definitions have one thing in common which is that they emphasize that each member of the population should have access to available financial services.

### **2.2. Government effort and success stories**

Financial inclusion has been a major policy objective for the government of many developing and emerging countries, and there is great promise that financial inclusion will bring the excluded population into the formal financial sector so that they can have access to formal financial products and services (Allen et al, 2016). Many governments are making tremendous efforts to achieve high levels of financial inclusion, such as: opening of bank accounts with minimal documentation requirements, using ultimatums to compel citizens to obtain a bank identification number, granting free debit cards, granting free insurance policies, using mobile technology to access finance, adopting a direct government to person (G2P) payment system, enrolling for mortgage without having to make compulsory equity down payment, the large-scale use of bank correspondents, etc.

There have been many success stories of financial inclusion around the world particularly in India (Nimbrayan et al, 2018), Rwanda (Lichtenstein, 2018; Otioma et al, 2019), Kenya (Ndung'u, 2018; Hove and Dubus, 2019) and Peru (Cámara and Tuesta 2015). In India, the PMJDY program improved the level of financial inclusion for many citizens and became a big success in the early years of the program.<sup>1</sup> The later years of the PMJDY program witnessed some supply-side challenges such as low supply incentives and low subsidy to providers of financial services.<sup>2</sup> In Rwanda, the community savings and credit cooperatives (SACCOs) have been a financial inclusion success story. In just three years, these cooperatives, known as Umurenge SACCOs, have attracted over 1.6 million customers and 90% of Rwandans now live within a 5 kilometer radius of an Umurenge SACCO.<sup>3</sup> In Kenya, the M-Pesa has been the primary instrument to achieve greater financial inclusion for the Kenyan people. The introduction of M-Pesa in 2007 profoundly transformed Kenya's financial system. Through the M-Pesa, the level of financial inclusion rose from 26.4% in 2006 to 40.5% in 2009 and the level of financial exclusion declined from 39.3% to 33%.<sup>4</sup> In Peru, an interoperable mobile money platform called 'Modelo Peru' was launched to bring mobile financial services to those who need it, with the aim of promoting financial inclusion. There is also the 'Bim' service in Peru that enables any Peruvian with a mobile phone to open a bank account and make payments and this can be done without ever having to visit a bank.<sup>5</sup>

There is no doubt that the financial inclusion programmes and policies adopted in some countries have been successful. Yet, the two major concerns that often arise is that financial inclusion may spread risk to poor and vulnerable customers in society and increase the number of high-end (or high-income) consumers benefiting from financial institutions. The second concern is whether financial inclusion should be targetted to those who have never been included in the formal financial sector or to those who have been relatively distant to using formal financial products more and more frequently.

### **2.3. Connecting the policy and academic literatures**

The policy literature contains many idealistic interpretations on how to achieve financial inclusion while the academic literature is mostly focused on the relationship between financial inclusion and poverty levels and income inequality as well as the effect of financial inclusion on the economy (Sarma and Pais, 2011; Morgan and Pontines, 2014; Mehrotra and Yetman, 2015; Demirgüç-Kunt and Klapper, 2013a; Cull et al, 2013). These two literatures are quite interesting even though there is no synergy between the academic and policy literatures. But theories are powerful because they can help to bring the two literatures together. Theories can explain why different ideas exist on what financial inclusion objectives should be and how to achieve financial inclusion. Theories can explain the current observations in financial

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<sup>1</sup> <https://www.pmjdy.gov.in/files/stories/Central-Bank-of-India.pdf>

<sup>2</sup> <https://www.cgap.org/blog/pmjdy-improved-financial-inclusion-roadblocks-remain>

<sup>3</sup> [https://www.afi-global.org/sites/default/files/publications/afi\\_case\\_study\\_rwanda\\_finalweb.pdf](https://www.afi-global.org/sites/default/files/publications/afi_case_study_rwanda_finalweb.pdf)

<sup>4</sup> <https://www.bsg.ox.ac.uk/sites/default/files/2018-06/2017-07-M-Pesa-Practitioners-Insight.pdf>

<sup>5</sup> <https://www.mastercardcenter.org/insights/modelo-peru-collaboration-creates-interoperability>

inclusion practice and can also explain abnormal deviations that exist in practice so that a coherent system of principles for financial inclusion can be developed. Therefore, a good financial inclusion theory is one that provide a logical system of ideas to explain financial inclusion objectives, processes or outcomes. To understand why certain financial inclusion objective yield certain outcomes, we need to first understand the behavior of the agents involved in the financial inclusion process, and a theory or principles of financial inclusion can help explain this as well.

#### **2.4. The need for a theory of financial inclusion**

Why do we need a theory or set of theories of financial inclusion? We need a theory of financial inclusion to achieve a high level of synthesis between financial inclusion objectives and financial inclusion outcomes. A financial inclusion theory or set of theories would provide a system of ideas that explain financial inclusion objectives, processes and outcomes. Financial inclusion theories can consolidate the recent idealistic debates in the policy literature on financial inclusion. Financial inclusion theories can also provide a set of principles on which the practice of financial inclusion is based, and would make it possible to detect abnormal patterns in financial inclusion practice which would elicit further research to improve our understanding of why deviations exist in practice. Generally, in problem-driven social science research, researchers often use one or multiple theories to analyse a problem and to solve a problem. This suggest that the theories for describing a financial inclusion problem may differ from the theories for its solution. Similarly, the theories for identifying the beneficiaries of financial inclusion may differ from the theories for the delivery and funding of financial inclusion activities.

### **3. Theories of financial inclusion beneficiary**

Conflicting ideas or perspectives exist on who benefits from financial inclusion outcomes. Some studies argue that poor people are the ultimate beneficiaries of financial inclusion (Bhandari, 2018), others think that women are the beneficiaries of financial inclusion outcomes (Ghosh and Vinod, 2017; Demirguc-Kunt et al, 2013b; Swamy, 2014) while some think that the economy and the financial system are beneficiaries of financial inclusion (Mehrotra and Yetman, 2015; Kim et al, 2018; Swamy, 2014; Ozili, 2018). Apart from women and poor people, there are other potential beneficiaries of financial inclusion that have been ignored in the literature such as young people, elderly people, institutionalized people, people with disabilities, and individuals who have been expelled from the financial sector for committing criminal offenses. Below are four theories that explain who benefits from financial inclusion.

#### **3.1. Public good theory of financial inclusion**

The public good theory of financial inclusion argues that the provision of formal financial services should be treated as a public good. The theory argues that formal financial services is a public good, and should be provided to everyone for the benefit of all. There should be unrestricted access to finance for everyone. As a public good, access to formal financial services to one individual does not reduce its availability to others. This means that all members of the population can be brought into the formal financial sector and

everyone will be better-off. Under this theory, all members of the population are beneficiaries of financial inclusion and nobody is left out.

Under the public good theory of financial inclusion, an individual or small business that opens a formal bank account can be offered free debit cards. They can use the Automated Teller Machines (ATMs) to perform transactions without being charged a transaction fee. Suppliers of formal financial services, such as financial institutions, will bear the cost of offering formal financial services as a sunk-cost of doing business. The government can grant subsidies to financial institutions to help them cope with any resulting cost problems that arise from offering free formal financial services to citizens.

The public good theory of financial inclusion has three merits. Firstly, the public good theory suggests that everyone will benefit from financial inclusion regardless of status, income level or demographic differences. Secondly, as a public good, the government will subsidize the cost of providing formal financial services to citizens. Thirdly, as a public good, it gives the government an opportunity to take responsibility for promoting financial inclusion.

The public good theory of financial inclusion has three demerits. Firstly, treating the provision of formal financial services to citizens as a public good does not address the real cause of financial exclusion. Secondly, treating the provision of formal financial services to citizens as a public good will require the government to subsidize the cost of providing formal financial services to citizens. Such subsidy can deplete public funds, and lead to insufficient public funds to execute other important public projects. Thirdly, the public good theory assumes that the provision of formal financial services as a 'public good' is free-of-charge or comes at a very low cost to users of formal financial services. When the provision of formal financial services is treated as a public good, the level of financial inclusion may not be sustainable in the long-term even when supported with public funding if the cost of formal financial services is underpriced.

### **3.2. Dissatisfaction theory of financial inclusion**

The dissatisfaction theory of financial inclusion argues that financial inclusion programs in a country should first be targeted to all individuals who were previously in the formal financial sector but left the formal financial sector because they were dissatisfied with the rules of engagement in the formal financial sector, or had some unpleasant personal experience when dealing with firms and agents in the formal financial sector.<sup>6</sup> This theory suggests that it is easier to bring back people who left the formal financial sector because they were dissatisfied if the areas of dissatisfaction in the formal financial sectors have been completely resolved. The theory argues that it is easier to bring back this group of individuals into the formal financial sector through persuasion than to bring in those who have never been in the formal financial sector. The implication of this theory is that the members of the population that left the formal financial sector should be the first target of financial inclusion before extending financial inclusion programs to other members of the population. Banked adults may become dissatisfied for several reasons such as when they are victims of financial fraud, debit or credit card fraud, financial theft, long waiting

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<sup>6</sup> Such unfavorable experiences may include debit/credit card frauds, long waiting periods before depositors are able to withdraw funds, taking too long before payments are cleared, high transaction costs, excessive bank charges, etc.

hours before depositors are able to withdraw funds, taking too long before payments are cleared, high transaction costs, excessive bank charges, etc.

The dissatisfaction theory of financial inclusion has some merits. Firstly, the theory makes a deliberate attempt to deal with the 'voluntary financial exclusion' problem. It reduces the level of voluntary financial exclusion by using persuasion to bring back those who left the formal financial sector due to dissatisfaction. Secondly, it is easy to identify the financially-excluded members of the population. Previously banked adults who are now unbanked can be easily identified because their personal data are stored with financial institutions. They can be reached to be persuaded to return to the formal financial sector. It is easier to achieve financial inclusion by reaching out to previously banked adults than to reach out to members of the population that have never joined the formal financial sector. Thirdly, under this theory, achieving financial inclusion does not require the use of public funding since it relies strongly on interpersonal persuasive skills and abilities.

The dissatisfaction theory of financial inclusion has some demerits. Firstly, the theory does not prioritize financial inclusion for everybody in the population. It excludes people who have never been in the formal financial sector. Secondly, the dissatisfaction theory implicitly assumes that financial exclusion is caused by customers' dissatisfaction with the rules of engagement in the formal financial sector. This may not be the case under certain circumstances because individuals can voluntarily exit the formal financial sector for other reasons such as religious and personal reasons (Ozili, 2018). Finally, individuals who are dissatisfied with the behavior of financial institutions in the formal financial sector may have no choice but to remain in the formal financial sector if societal culture relies too much on the formal financial sector to live a comfortable life.

### **3.3. Vulnerable group theory of financial inclusion**

The vulnerable group theory of financial inclusion argues that financial inclusion programs in a country should be targeted to the vulnerable members of society who suffer the most from economic hardship and crises, such as poor people, young people, women, and elderly people. The theory argues that vulnerable people are often the most affected by financial crises and economic recession, therefore, it makes sense to bring these vulnerable people into the formal financial sector. One way to achieve this is through government-to-person (G2P) social cash transfers into the formal account of vulnerable people. Making G2P social cash transfer payments into the formal account of poor people, young people, women, and elderly people can encourage other vulnerable people – poor people, young people, women, and elderly people – to join the formal financial sector to own a formal account to take advantage of the G2P social cash transfer benefits, thereby, increasing the rate of financial inclusion for vulnerable groups. Also, when social cash transfer is working, and other tools for achieving financial inclusion are provided to vulnerable people in society, it can make vulnerable people feel that they are being compensated for the existing income inequality that affect them, and it gives them an opportunity to catch up with other segments of society. The implication of theory is that financial inclusion efforts should be the targeted to vulnerable people in society.

The vulnerable group theory of financial inclusion has some merits. Firstly, the theory makes an attempt to reduce the financial exclusion problem by targeting vulnerable groups to bring them into the formal



financial sector. Secondly, under this theory, it is easy to identify the financially-excluded members of the population. The vulnerable members of the population can be identified by their degree of vulnerability in terms of income level, gender, age, and other demographic characteristics. Thirdly, it may be cost-effective to target only the vulnerable members of the population for financial inclusion compared to achieving financial inclusion for the entire population.

The vulnerable group theory of financial inclusion has some demerits. Firstly, the theory does not prioritize financial inclusion for everybody in the population. Secondly, it ignores non-vulnerable people outside the formal financial sector. Non-vulnerable people also need access to formal financial services. Thirdly, it assumes that women are a vulnerable group, which implies that men are not a vulnerable group. This idea is critical because in modern societies women and men compete for equal opportunities, therefore, labelling women as a vulnerable group to the exclusion of men may have unintended consequences for financial and social inclusion. It could lead to societal resentment among the men towards women. Finally, achieving financial inclusion by targeting only vulnerable people may increase social inequality when social policies, and financial policies, are designed to favour vulnerable people over others. It may also lead to income inequality if vulnerable people receive better access to formal financial services for a sustained period of time than others.

### **3.4. Systems theory of financial inclusion**

The systems theory of financial inclusion states that financial inclusion outcomes are achieved through the existing sub-systems (such as the economic, social and financial systems) which financial inclusion rely on, and as a result, greater financial inclusion will have positive benefits for the sub-systems it relies on. A significant change in a sub-system (one part of the system) can significantly affect the expected financial inclusion outcome. For instance, imposing regulation on financial sector agents (who are a part of the financial system) can align their interest with that of the users of basic financial services, and can compel financial sector agents to offer affordable and quality financial services to users within defined rules that protect users of formal financial services from exploitation and price discrimination.

On the other hand, a significant change at the full system level – such as replacing the existing national financial inclusion plan with a completely new plan – does not necessarily lead to a change in the existing sub-systems because a change in the sub-system must be done at the sub-system level. The theory suggests that (i) the efficiency and effectiveness of the sub-systems will determine the success or failure of a national financial inclusion agenda, and (ii) the existing sub-systems (economic, financial or social) in a country are the ultimate beneficiaries of financial inclusion, under the systems theory perspective.

The systems theory of financial inclusion has some merits. Firstly, the systems theory recognizes the role of existing economic, financial and social systems or structures in a country in promoting financial inclusion. Secondly, it provides a macro perspective on financial inclusion compared to other theories with a micro-perspective. Thirdly, the systems theory of financial inclusion considers how financial inclusion outcomes are affected by the interrelationship among the sub-systems that financial inclusion relies on.

The systems theory has some demerits. Firstly, the existing sub-systems are a reflection of the environment. In some environments, the existing sub-systems may not function properly, and as a result,

the expected financial inclusion outcomes may not be fully achieved. Secondly, the systems theory of financial inclusion does not recognize the influence of factors outside the full system that could affect financial inclusion outcomes, rather it focuses on the effect of the sub-systems on financial inclusion outcomes. Thirdly, the systems theory of financial inclusion assumes that there is a direct relationship between financial inclusion outcomes and the systems it relies on.

## **4. Theories of financial inclusion delivery**

There are several ideas on who should deliver, or provide, formal financial services to the people. Some think the government should provide formal financial services to the people (Aggarwal and Klapper, 2013; Staschen and Nelson, 2013; Chibba, 2009). Others argue that private corporations, such as banks and financial technology businesses, can deliver formal financial services to the people more efficiently (Gabor and Brooks, 2017; Ozili, 2018). There are also ideas suggesting that formal financial services can be delivered through cooperation by the public and private sectors (Arun and Kamath, 2015; Pearce, 2011). These expectations regarding the delivery, or provision, of formal financial services need an underlying thought-process to establish why these agents are necessary in the first place to deliver formal financial services. Some theories or perspectives on financial inclusion delivery are provided below.

### **4.1. Community echelon theory of financial inclusion**

Community echelon theory of financial inclusion states that formal financial services should be delivered to the excluded population through their communal leaders. The theory argues that community leaders are influential in their communities and can use their influence to encourage or persuade community members to join the formal financial sector. Community plays an important role in shaping the values of its leaders and members. Community members trust their leaders and believe their leaders would make decisions that are beneficial to them while community leaders will ensure that the decisions they make reflect the values and ethos held by members of the community. Community leaders can be instrumental in bringing their members into the formal financial sector because the strong cultural ties between community leaders and members makes it possible for community leaders to persuade their members to participate in the formal financial sector.

The merit of the community echelon theory of financial inclusion is that communal leaders can influence community members into making changes that improve their welfare. Communal leaders can encourage members of the community to join the formal financial sector so that members of the community can have access to formal financial services.

The community echelon theory of financial inclusion has some demerits. One, the influence of communal leaders can rebound if communal leaders are self-serving and corrupt. Secondly, agency problems may arise in the form of nepotism, fraud and corruption. Communal leaders can be pressured to make decisions that are not in the best interest of the people when they are unduly pressured by promoters of financial inclusion using financial or non-financial forms of gratification. Since communal leaders are

believable, decisions that are not in the best interest of the community members can be reached. Thirdly, community members already participating in the formal financial sector may have worries and anxiety about the formal financial sector which they may not articulate to their community leaders. The higher the anxiety, the more likely they will leave the formal financial sector after a while. Finally, since there are different leadership styles, it is difficult to determine which leadership style works best to influence community members to change their beliefs towards participating in the formal financial sector.

#### **4.2. Public service theory of financial inclusion**

Public service theory of financial inclusion states that financial inclusion is a public responsibility which the government owe its citizens, and the citizens expect the government to deliver formal financial services to citizens. This theory argues that formal financial services should be delivered to all citizens by the government through public institutions. Under this theory, only the government is instrumental in achieving financial inclusion.

The public service theory of financial inclusion has some merits. One, the theory suggests that financial inclusion can be achieved when the government takes responsibility for financial inclusion. Secondly, the government has control over the financial system, economic and social structures in the country which the government can use to achieve its financial inclusion objectives. For example, the government can create public banks in the most remote areas of the country to reach the excluded members of the population in those areas. Thirdly, there is increased public confidence when the government assumes full responsibility for financial inclusion through public institutions. Members of the population are confident that financial inclusion programs will work for the greater good of everyone when the government takes full responsibility for financial inclusion.

Some demerits of the public service theory of financial inclusion include the following. One, it does not consider private-sector participation in delivering formal financial services to citizens. Secondly, it assumes that financial inclusion will be funded with taxpayers' money. Tax revenue may be insufficient to fund the delivery of formal financial services to a large segment of the population. Thirdly, the State can use political power as a means of control over society. During good times, the State can provide formal financial services to obedient citizens; meanwhile, the State can stop providing formal financial services to citizens when citizens revolt against the State.

#### **4.3. Special agent theory of financial inclusion**

The special agent theory of financial inclusion argues that formal financial services should be delivered to the excluded population by special agents. Often, the provision of formal financial services to unbanked adults can be difficult due to the nature of remote communities, its people or the geography. For this reason, there is need to employ the services of specialized agents to deliver formal financial services to members of excluded communities. Under this theory, the special agent is expected to be: (i) a highly skilled and specialized agent, (ii) understand the peculiarities of the excluded population, (iii) understand the existing informal financial system in communities where the excluded members of the population reside, (iv) identify areas for improvement through innovation, and (v) devise a way to integrate the informal financial system in excluded communities into the formal financial system.

The special agent is considered to be competent, highly skilled and has superior ability to bring the excluded population into the formal financial sector so that they can have access to formal financial services. Under this theory, there is an agent-principal relationship. The principal is often the national government, foreign government or foreign organization while the special agent is often a local bank, non-bank institution or a special institution created for the sole purpose of achieving specific financial inclusion objectives. Financial institutions and technological companies can also play the role of special agent.

The special agent theory of financial inclusion has some merits. Firstly, it employs the services of specialized agents to deliver formal financial services to excluded members of the population. Employing the services of specialized agents to deliver formal financial services allows the government to focus on other important and pressing national issues. Secondly, the government has high degree of confidence in the ability of the special agent to deliver formal financial services to the excluded population. The special agent could be an organization comprised of skilled individuals and experts affiliated with, or in collaboration, with other specialized institutions to harness collaborative inputs to reach the common goal of greater financial inclusion. Thirdly, there is no ambiguity about the financial inclusion targets to be achieved, and the compensation to the special agent is pre-determined. The special agent knows what the objective is, they know the expectations, and they know the compensation they will receive for their work, thus, there is no ambiguity. Finally, the special agent relationship is not affected by the fundamental principal-agent problems in agency theory. The principal-agent problem in agency theory occurs when the agent, who is the manager of a firm, is driven by self-interest to appropriate excess financial resources (money) to oneself at the expense of shareholders (see Jensen and Meckling, 1976 for agency theory). In contrast, the special agent for financial inclusion cannot appropriate excess financial benefits to itself.

The special agent theory of financial inclusion has some demerits. Firstly, if the principal is the government, the government may choose its own agency as the special agent, making the government both the principal and the agent. This would defeat the purpose of special agency in delivery formal financial services. The government should not be the principal and the special agent at the same time because government agencies are often inefficient. Secondly, a special agent can abandon the financial inclusion program when there is a breach in contractual terms or a breach in conditions for service by the principal (who is often the government). This may arise from insufficient compensation to the special agent by the principal or the failure of the principal to provide the funds needed to fund the completion of financial inclusion programs.

#### **4.4. Collaborative intervention theory of financial inclusion**

Collaborative intervention theory of financial inclusion states that formal financial services should be delivered to the excluded population by collaborative intervention from multiple stakeholders. The theory suggests that joint effort from multiple stakeholders is needed to bring the excluded population into the formal financial sector.

The collaborative intervention theory of financial inclusion has some merits. One, it encourages a multi-stakeholder approach in the provision of formal financial services. Secondly, the collaborating

stakeholders have a sense of satisfaction for being a significant contributor to the financial inclusion program.

The collaborative intervention theory of financial inclusion has some demerits. One, it is difficult to determine the optimal number of collaborators needed to deliver formal financial services to the excluded population. Secondly, some collaborators may become inactive leaving the task for few active collaborators to do. Thirdly, having higher number of collaborators does not guarantee higher probability of success in delivering formal financial services to the excluded population.

#### **4.5. Financial literacy theory of financial inclusion**

Financial literacy theory of financial inclusion states that financial literacy will increase people's willingness to join the formal financial sector. It argues that financial inclusion can be achieved through education that increases the financial literacy of citizens. When people become financially literate, they will seek formal financial services wherever they can find it.

The financial literacy theory of financial inclusion has some merits. One, financial literacy can make people aware of formal financial services that are available to them. When they become aware of existing formal financial services that can improve their welfare, they will join the formal financial sector by owning a formal account. Secondly, through increased financial literacy, people can take advantage of other benefits in the formal financial sector such as investment and mortgage products. Thirdly, financial literacy can also help people become self-sufficient and help them have some stability in their personal finance. Financial literacy can help people to distinguish between needs and wants, helping them to create and manage a budget, teaching them to save so that they can pay bills when due, and to plan for retirement. Finally, governments that have limited public funds, or limited tax revenue, to fund financial inclusion programs may prefer to use financial literacy as a national strategy for financial inclusion because it is relatively cheaper to educate the population about financial management and the benefits of using formal financial services.

The demerits of the financial literacy theory of financial inclusion include the following. One, it addresses the 'willingness' not 'capacity' to join the formal financial sector. Financial literacy through education can improve the willingness of people to join the formal financial sector but it does not necessarily improve 'capacity' to join the formal financial sector, where capacity is measured as having money which can be used to perform one or more financial transactions. This means that people who do not have money (that is, lack of 'capacity') cannot actively participate in the formal financial sector even if they are financially literate.

## 5. Theories of financial inclusion funding

The question: who should fund financial inclusion expenditure for the people – is an important question. Some think public money (tax-payers fund) should be used to fund financial inclusion programs (Marshall, 2004). Others feel that the capitalists in the private-sector should fund financial inclusion programs because they contributed to widen the income inequality gap between the poor and the rich (Mohiuddin, 2015). There are also ideas suggesting that financial inclusion programs should be jointly funded by the public and private sectors (Dashie et al, 2013; Cobb et al, 2016). Below are some theories of financial inclusion funding.

### 5.1. Private money theory of financial inclusion

Private money theory of financial inclusion states that financial inclusion programs should be funded using private money (e.g. shareholders' equity capital) because private funders will (i) require greater accountability from the users of their funds, (ii) ensure that private funds are utilized efficiently, and (iii) ensure that formal financial services are delivered to the excluded members of the population.

The merits of private money theory of financial inclusion include the following. One, there is shorter approval time to obtain private funding for financial inclusion programs compared to the long approvals required to obtain public funding. Private funders can reach decisions more quickly because there are only few stages through which an application for private funding must go before it is finally approved. Secondly, private funders often participate in financial inclusion programs either through equity ownership or by donations. Thirdly, private funders can take ownership of the financial inclusion program, and can gain income when they manage financial inclusion programs themselves. They can also exchange benefits with the local authorities. Four, it is easy to increase charges from users to meet the cost of financial inclusion programs when the primary funder is a private person or corporation. Five, private financiers can offer better project management skills, innovative facilities, and effective risk management in achieving financial inclusion objectives. Six, private funders can exert greater pressure on private contractors to finish all financial inclusion programs in good time while maintaining high quality.

Some demerits of private money theory of financial inclusion include the following. One, the cost of raising private funds to fund financial inclusion projects may be too high. Secondly, funding financial inclusion programs using private money can increase private interests in financial inclusion outcomes to the detriment of poor people and the excluded population. Thirdly, there may be loss of government control over the financial inclusion infrastructure created by private investors due to partial or full private ownership by private investors.

### 5.2. Public money theory of financial inclusion

Public money theory of financial inclusion states that financial inclusion programs should be funded using public money (e.g. tax payers fund). This theory argues that financial inclusion programs should be funded from government budgets. There is evidence that public funding for financial inclusion is growing faster than private funding (see Dashie et al, 2013).

Some merits of the public money theory of financial inclusion include the following. One, the government can tax the rich to generate funds for financial inclusion programs for the benefit of all. This would lead to the redistribution of income and reduce income inequality for the benefit of the poorer segment of the population. Secondly, the cost of raising public funds to fund financial inclusion programs is low or negligible. Thirdly, funding financial inclusion programs using public money can prevent self-interested individuals from hijacking the financial inclusion agenda for their own selfish benefit.

Some demerits of public money theory of financial inclusion include the following. One, lack of proper planning is a major problem associated with public funding. Lack of planning can lead to overspending on financial inclusion programs which can ultimately lead to inefficiency. Secondly, using public money to fund financial inclusion programs can lead to unnecessary delays in reaching the excluded population, such as delays in disbursing funds, delays caused by lobbying and delays due to political events. Thirdly, governments with insufficient funds will be pressured to raise debt to fund financial inclusion programs. This will increase the debt burden of the government. Finally, improper delegation of authority may arise when the task of achieving financial inclusion is delegated to an incompetent institution. Usually, governments often make one of its competent agencies responsible for achieving its financial inclusion objectives rather than creating a new agency. Often, the appointed agency already has its own statutory duties, and maybe overburdened with the additional task of promoting financial inclusion.

### **5.3. Intervention fund theory of financial inclusion**

The intervention fund theory of financial inclusion argues that financial inclusion activities and programs should be funded from special interventions by diverse funders rather than using taxpayers' money. It argues that many 'special funders' exist in the world such as philanthropists, non-governmental organizations and foreign governments. These special funders often support inclusive development finance programs for the global population. In some economies, cross-border funding has the largest share of financial inclusion funding, and much of these funding have been allocated to microfinance institutions (El-Zoghbi et al, 2011). Special funders can choose the financial inclusion programs they wish to fund to completion and will provide the 'intervention fund' required to achieve the desired financial inclusion objectives.

The intervention fund theory of financial inclusion theory has some merits. One, it by-passes the usual political bureaucracy associated with allocating public funds for public projects. Secondly, the special funders can mobilize capital and human resources, both locally and internationally, to assist them in achieving the desired financial inclusion objectives. Thirdly, special funders can create new institutions that are pro-development to help them achieve the desired financial inclusion objective. These institutions will remain in the community to promote development even after the financial inclusion projects are completed.

The intervention fund theory of financial inclusion has four demerits. Firstly, under this theory, special funders would need to develop a methodology to determine which segments of the population are excluded from the formal financial sector. Secondly, the methodology used by special funders to determine which members of the population are financially excluded may not accurately identify the members of the population that are financially excluded. Thirdly, using intervention funds from foreign

governments or foreign donors to fund development projects in a country can damage the reputation of a country as it signals that the government is unable to use its own funds to spur development for its own people.

## **6. Applying the theories of financial inclusion to data**

### **6.1. Empirical data**

Data are records from past observations. Every data or observation from financial inclusion practice should be understood in terms of a prior, often implicit theory. This idea is consistent with Popper (1976) who argued that theory should precede observation. Data for financial inclusion can be obtained using direct observations, interviews and surveys. Data obtained from financial inclusion practice, and the analysis of such data, should support or refute the above-discussed theories of financial inclusion. Better theories of financial inclusion should replace poorer ones if they explain existing observations more effectively. Also, the empirical modelling of financial inclusion determinants should take into account the nature of the data and the magnitude of the explained and unexplained variation in a financial inclusion model.

### **6.2. Case studies**

Scholars may use case studies to develop interesting theories of financial inclusion. Building a financial inclusion theory from case studies is a research strategy that involves using one or more cases to create theoretical constructs and propositions from case-based research (Eisenhardt, 1989). Case studies are often descriptions of particular instances of a phenomenon that are based on a variety of data sources (Yin, 1984).

Cases can be historical accounts of financial inclusion success or failures in several countries. Each case study on financial inclusion can serve as a distinct experiment that stands on its own as an analytic unit while multiple case studies can serve as discrete experiments that serve as replications, contrasts, and extensions to existing or new theories. Building theories of financial inclusion from case studies is likely to become a popular and more relevant research strategy for future studies on financial inclusion. Case studies have some limitations, such as the small sample associated with case studies and the one-sided interviews that increases informant bias. These issues can be mitigated by careful choice of sample and by conducting fair interviews or surveys that limit informant bias.



## 7. Conclusion

This paper presented new theories of financial inclusion that can be used in financial inclusion research and policy debates. The purpose of this article has been to argue that financial inclusion needs to be studied from a theoretical perspective. Several theoretical perspectives have been provided. So far, many financial inclusion topics have yet to be sufficiently studied, and theories have been underutilized in the financial inclusion debate. The theories presented in this paper can serve as a guide for what needs to be done but researchers who are not experts in financial inclusion will inevitably need more resources in addition to this one.

This paper is a practical description and does not directly address how to test the relative effectiveness of each financial inclusion theory for the purpose of empirical modeling. Nevertheless, the paper does suggest ways in which using these theories can change how we think about financial inclusion beneficiaries, delivery and funding. Also, using these theories can remove from the literature extreme idealism. Using these theories will help researchers ensure that the theoretical constructs they use are actually used all the way through the financial inclusion theory building process and will improve evidence-based summaries, thereby advancing our understanding of financial inclusion.

A possible direction for future research is to develop a glossary of financial inclusion success stories across countries. Secondly, many additional theories of financial inclusion can be developed, and there is no limit to the number of new theories or ideas that can be developed or explored. Thirdly, there is need to test these theories using a rich data sample.

Finally, although this paper has argued the need of theory to understand financial inclusion, some advice for practitioners and policy makers are stated below. Digital finance and financial innovations should be used to achieve financial inclusion in a way that minimise tail risk to poor and vulnerable customers. Policies should be developed that encourage competition in the delivery of formal financial services. Governments should consider granting subsidy to providers of financial services so that they can offer basic financial services to the excluded population at a very low cost or free-of-charge. Governments should establish a communication channel that allow citizens to express their thoughts about whether financial services have been offered to them fairly and at a cheap fee and without discrimination.

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## Appendix

Table 1: Summary of theories of financial inclusion

S/N	Theory	Category	Merit/Advantage	Demerit/Advantages
1.	Public good theory	financial inclusion beneficiary	(i) everyone will benefit from financial inclusion and nobody will be left out; (ii) the State subsidizes the cost of formal financial services; (iii) the State takes responsibility for financial inclusion	(i) it does not address the real cause of financial exclusion; (ii) subsidizing the cost of formal financial services reduces funding for other important national projects; (iii) financial inclusion may become unsustainable when treated as a public good; (iv) may not be useful in explaining financial inclusion in countries where most financial institutions are privately funded.
2.	Dissatisfaction theory	financial inclusion beneficiary	(i) it deals with the voluntary financial exclusion problem; (ii) it is easy to identify the financially-excluded members of the population; (iii) achieving financial inclusion does not require the use of public funds.	(i) the theory does not prioritize financial inclusion for everybody in the population; (ii) financial exclusion may not be caused by customers' dissatisfaction with the formal financial sector.
3.	Vulnerable group theory	financial inclusion beneficiary	(i) it reduces the financial exclusion problem by targeting vulnerable groups; (ii) it is cost-effective to target only the vulnerable members of the population	(i) does not prioritize financial inclusion for everybody in the population; (ii) it ignores non-vulnerable people outside the formal financial sector; (iii) it assumes that women are a vulnerable group, which suggest that men are not a vulnerable group.
4.	Systems theory of financial inclusion	financial inclusion beneficiary	(i) it recognizes the role of existing sub-systems (economic, financial and social systems or structures) in a country in promoting financial inclusion; (ii) it views financial inclusion from a macro perspective; (iii) it considers how financial inclusion outcomes are	(i) it does not recognize the influence of factors outside the system that could affect financial inclusion outcomes; (ii) it assumes that there is a direct relationship between financial inclusion outcomes and the systems it relies on.

			affected by the interrelationship among existing sub-systems	
5.	Community echelon theory	financial inclusion delivery	(i) communal leaders can influence community members into making changes that improve their welfare.	(i) the influence of communal leaders can rebound if communal leaders are self-serving and corrupt; (ii) communal leaders can be pressured to make decisions that are not in the best interest of the community members; (iv) agency problems may arise in form of nepotism, fraud and corruption.
6.	Public service theory	financial inclusion delivery	(i) financial inclusion can be achieved when the government is responsible for financial inclusion; (ii) the government can use the existing economic, social and political systems to achieve its financial inclusion objectives; (iii) there is increased public confidence when public institutions assumes full responsibility for financial inclusion	(i) it does not consider private-sector participation in promoting financial inclusion; (ii) tax revenue may be insufficient to fund large financial inclusion programs.
7.	Special agent theory	financial inclusion delivery	(i) it requires the services of specialized agents to promote financial inclusion in the country; (ii) it allows the government to focus on other important and pressing national issues; (iii) government is high degree of confidence in the ability of special agents; (iv) there is no ambiguity about the financial inclusion targets to be achieved; (v) the special agent relationship is not affected by the fundamental principal-agent problems in agency theory.	(i) the government may choose its own agency as the special agent, making the government both the principal and the agent; (ii) the private special agent can abandon the financial inclusion project if contractual terms are breached.
8.	Collaborative theory	financial inclusion delivery	(i) it encourages a multi-stakeholder approach to achieve financial inclusion; (ii) the	(i) it is difficult to determine the optimal number of collaborators needed to achieve financial

			collaborating stakeholders have a sense of satisfaction for being a significant contributor to a public project.	inclusion objectives; (ii) some collaborators may become inactive leaving the task for few active collaborators to do; (iii) having higher number of collaborators does not guarantee higher probability of achieving success in financial inclusion.
9.	Financial literacy	financial inclusion delivery	(i) Financial literacy increases awareness of available basic financial services; (ii) financial literacy can help people become self-sufficient and can help them have some stability in their personal finance; (iii) governments that have limited public funds may prefer to use financial literacy as a national strategy for financial inclusion since it does not require much public fund	(i) the financial literacy theory addresses the 'willingness' not 'capacity' to participate in the formal financial sector.
10.	Private money theory	financial inclusion funding	(i) there is shorter approval time to obtain private funding for financial inclusion projects; (ii) private funders are directly involved through equity ownership or donations; (iii) private funders can take ownership of the project; (iv) private financiers can offer better project management skills, innovative facility and risk management in achieving financial inclusion objectives; (iv) private funders can exert greater pressure on private contractors to finish all financial inclusion projects in good time while maintaining high quality.	(i) the cost of raising private funds to fund financial inclusion projects may be high; (ii) funding financial inclusion objectives using private money can increase private interests in financial inclusion outcomes; (iii) there may be loss of government control over the financial inclusion infrastructure created by private investors.
11.	Public money theory	financial inclusion funding	(i) the government can tax the rich to generate funds for financial	(i) lack of proper planning is a major problem associated with public

			<p>inclusion projects for the benefit of all; (ii) the cost of raising public funds to fund financial inclusion projects is low or negligible; (iii) funding financial inclusion objectives using public money can prevent individuals from hijacking the financial inclusion agenda for self-benefit.</p>	<p>funding; (ii) using public money to fund financial inclusion projects can lead to unnecessary delays in reaching the excluded population; (iii) governments with insufficient funds may be pressured to obtain loans which will increase the national debt level; (iv) improper delegation of authority may arise when the task of achieving financial inclusion is delegated to an incompetent authority.</p>
12.	intervention fund theory	financial inclusion funding	<p>(i) it by-passes the usual political bureaucracy associated with allocating public funds for public projects; (ii) the special funders can mobilize financial and human resources, both locally and internationally, to achieve the desired financial inclusion objectives; (iii) special funders can create new institutions that are pro-development to help them achieve the desired financial inclusion objective</p>	<p>(i) special funders would need to develop a methodology to determine which segments of the population are excluded from the formal financial sector; (ii) special funders may use an unfair methodology or criteria to determine which population members are financially excluded; (iii) using intervention funds from foreign governments or foreign donors to fund development projects in a country can damage the reputation of the country.</p>