POLICY BRIEF

Financial Inclusion and Entrepreneurship in Six sub-Saharan African Countries: Evidence from Finaccess and Finscope Survey Data

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Abstract

This paper investigates how financial inclusion affects individuals' decisions to start businesses in the context of six sub-Saharan African countries, using micro-data from the FinScope and FinAccess surveys. To do so, we use an instrumental variable (IV) technique to assess the empirical relationships. Overall, the results reveal that access to both banking services, formal non-banking services, informal financial services and mobile money services positively and significantly influenced the decision to start businesses in the six countries. Furthermore, although the results show that a range of both demand

and supply side barriers prevent individuals from accessing banking services for entrepreneurial purposes, supply side constraints are the most common barriers to individuals starting a business. In view of the above, policy interventions should first aim at creating an enabling environment to increase people's access to all types of financial services and secondly, address both supply and demand side constraints to promote entrepreneurship and economic growth. All of these measures should be aimed at increasing the level of financial inclusion with a view to stimulating entrepreneurial activities, which are the real pillars in the development and poverty reduction process in sub-Saharan African countries.

Introduction

For a number of years, both policymakers and researchers have recognized entrepreneurship as a key factor in economic development (Schumpeter, 1934; Brixiová, 2010; Aghion, 2017; Fan and Zhang, 2017). The underlying reason being that entrepreneurship is seen as an important driver for promoting innovation and structural transformation of economies (Audretsch et al. 2002). Some economists such as Bruton et al. (2013), Brixiová and Asaminew (2010) and Tobias et al. (2013), go even further to argue that entrepreneurship is one of the most effective tools in the global fight against poverty and, therefore, encourage policymakers in low-income countries to include entrepreneurship as a key element of their inclusive growth strategies (Brixiová and Égert, 2017). Similarly, according to Tchamyou (2016), promoting entrepreneurship, i.e., job creation, is one of the main remedies for dealing with the demographic surge, with its consequences in term of high unemployment rate in African countries[1].

Given the importance of entrepreneurial dynamics as a driver of poverty reduction, much of the theoretical and empirical literature in recent years has focused on identifying and analyzing the potential forces that can influence entrepreneurial activities. Thus, among the many factors identified in the literature, the issue of access to financial services figures prominently[2] (Schumpeter 1934; McKinnon 1973; Beck et al., 2009; Kerr et Nanda, 2009; Demetriades et Rewilak, 2019). Indeed, several theoretical studies have attempted to document how access to financial services can stimulate business creation. In this regard, we can mention those of King and Levine (1993) who identified two channels through which financial development can boost

1 According to World Bank data (2022), Sub-Saharan Africa unemployment rate for 2021 was 7.66%, a 0.38% increase from 2020. However, the number of unemployed has increased by a further one million due to high labour force growth rates in the region.

2 One of the channels identified in the theoretical literature through which financial development affects economic growth is the facilitation of business creation (Greenwood and Smith, 1997, Klapper et al., 2004).

business creation. First, as the financial sector develops, ex ante screening by lenders improves and entrepreneurs with high skill potential who are short of funds are able to obtain funds and thus start their businesses. Second, entrepreneurs are able to diversify risks more easily in more financially developed countries. Consequently, they invest in riskier and more profitable projects. In the same vein, the work of Evans and Jovanovic (1989), followed by Kan and Tsai (2006), demonstrates that financial constraints limit entrepreneurial activities. The theoretical work of Klapper et al (2004) also points in the same direction. Indeed, these authors argue that access to credit allows for greater market entry by talented new entrepreneurs, who would otherwise be constrained by lack of inherited wealth and lack of connection to the network of wealthy incumbents. Thus, greater access to credit for both individuals and firms (since small and micro enterprises are often started by individual borrowers), will increase the productivity returns to investment.

However, despite these theoretical arguments, from an empirical point of view, authors have so far failed to find clear and robust evidence of positive effects of access to financial services on entrepreneurship. As an illustration, in terms of positive effects, we can cite the work of Skyes et al. (2016), Blattman et al. (2014), Cho and Honorati (2013), Fan and Zhang (2017), and in terms of insignificant effects, the studies of Grimm and Paffhausen (2015), Van Rooyen et al. (2012).

Many arguments have been put forward in the literature to explain such a gap between theoretical predictions and empirical results. The main argument is that the availability of solid empirical evidence to support or refute these theories has been limited so far, due to a lack of adequate data on access to financial services. Indeed, most of the empirical work uses measures of the financial sector collected from financial institutions, such as private credit or the total value of bank deposits, which do not capture the distribution and allocation of these bank deposits or credit across the population (Ellis et al., 2010). Moreover, these indicators are still mostly limited to formal financial service providers. However, there is evidence that informal and semi-formal providers reach a much larger proportion of the population in many developing countries than banks. Indeed, several studies have pointed out that small firms, which consistently report higher barriers to growth than medium or large firms, are less likely to access formal finance (Brixiová et al., 2020). Developing a better understanding of the role of access to and use of financial services as a whole (including formal, semi-formal, informal, and mobile money accounts) is therefore an important and currently understudied area of investigation.

Another argument is that the issue of endogeneity has also not been considered in previous empirical studies. Indeed, it is quite likely that being an entrepreneur can also influence financial inclusion (reverse causality), in the sense that entrepreneurs offer more collateral than those without businesses to obtain better access to credit and other financial services. Other sources of endogeneity may also arise from the

existence of unobserved factors that may be correlated with both the dependent and independent variables. For example, some socio-demographic variables (e.g., age and gender) may have a direct impact on both entrepreneurship and access to financial services.

Ignoring this potential interdependence could lead to misleading conclusions about the actual relationship between financial inclusion and entrepreneurship and potentially over - or underestimate the true impacts of each of these. This, in turn, can have important consequences in terms of the effectiveness of economic strategies and policies to be implemented to foster both financial inclusion and entrepreneurship in developing countries.

This study therefore aims to contribute to the empirical literature, using the results of the more recently available FinScope and FinAccess household surveys on the use of financial services, in analyzing the relationship between financial inclusion and entrepreneurship in sub-Saharan African countries context[3].

By retaining the micro-data from the FinAccess and FinScope financial inclusion surveys, we will be able to more adequately address how people's access to and use of financial services affects their decision to start small and micro business. This is because the data is extremely rich and contains a wealth of information that is not available from any other source (Oumar et al., 2017). These databases contain nationally representative information on the use of and access to both formal and informal financial services. These surveys therefore capture important dimensions of financial inclusion as they are specifically designed to measure access to financial services (Allen et al., 2021). They provide a better understanding of the financial situation of a population, focusing on market needs and attitudes towards the provision and use of formal and informal financial services.

The questionnaires are based on the analysis of what respondents have and what they can do with what they have. Despite the richness of these new databases, they have been underused in empirical work to date. Also, the vast majority of previous work has focused on developed countries and very little has focused on developing countries, such as those in sub-Saharan Africa, due to lack of data (Lyons and Contreras, 2017). Yet, one of the major development challenges facing sub-Saharan Africa is the existence of high youth unemployment and low labour force participation rates among the working-age population (Anyanwu, 2014, Brixiová et al. 2015; AERC, 2014). Promoting entrepreneurship, i.e., job creation, is emerging as one of the main remedies to address the soaring unemployment in sub-Saharan African countries.

3 Based on data availability, we selected six countries in sub-Saharan Africa, namely Kenya, Rwanda, Tanzania, Uganda, Namibia, and Zambia.

In view of the above, this study aims to investigate the influence of financial inclusion on entrepreneurship in six sub-Saharan African countries using an instrumental variable estimation procedure to address the endogeneity problems suspected in the literature between the two variables.

In addition, the study goes further by seeking to identify which of the barriers to accessing financial services (supply or demand side) is most related to the likelihood of an individual committing to borrowing or saving for the purpose of business creation. This identification seems important to us as it will provide policy makers with more precise information on the types of barriers (demand or supply side) that they should focus on to boost entrepreneurship as an engine of economic growth.

Using a sample of six sub-Saharan African countries and after taking into account the endogeneity issue suspected in the literature between financial inclusion and entrepreneurship, we find that : (i) financial inclusion measured by the use of banking services, formal non-banking services, informal financial services and possession of a mobile money account positively affect individuals' decision to engage in entrepreneurship; (ii) access to a bank account can play an important role in helping individuals access credit for business creation. Indeed, econometric analysis (for Kenya, Rwanda, Namibia and Zambia) shows that individuals who cite supply-side barriers to accessing a bank account are less likely to save and borrow for entrepreneurial purposes than individuals who use them for purposes other than entrepreneurship, while in Tanzania and Namibia, these results show that individuals who cite demand-side constraints to accessing a banking service are less likely to save and borrow for entrepreneurial purposes than those who use these services for other purposes. These results, which represent, to our knowledge, the first quantitative estimates of the negative effect of access barriers on business creation, provide further strong evidence of the importance of addressing both supply and demand side access barriers, and in particular barriers to formal services to contribute to business creation and economic growth.

Data source

In this study, we use secondary data from *FinScope and FSD-FinAccess* surveys on access to and use of financial services in six sub-Saharan African countries conducted between 2015 and 2018 respectively. Countries were selected based on the availability of FinScope or FinAccess survey data. The study thus uses 2018 FinAccess national survey data for Kenya; 2018 Finscope national survey data for Uganda; 2016 Finscope national survey data for Rwanda; 2017 Finscope national survey data for Tanzania; 2017 Finscope national survey data for Namibia; 2015 Finscope national survey data for Zambia. The choice of these national surveys is justified by the fact that the FinAccess and FinScope surveys were conducted using broadly similar

stratified random sampling and a common methodology for defining financial access components (Ouma et al. 2017). It is important to recall that FinScope is a FinMark Trust initiative that aims to identify barriers to retail financial access by focusing on individuals' perceptions.

The questionnaires are based on the analysis of what the respondents have and what they can do with what they have. The dimensions that are considered are the individual, the household, and the community. First, the survey aims to identify the capabilities and limitations of individuals who use financial services: personal characteristics, attitudes and perceptions about life, the future, money and financial service providers, financial capabilities, and social networks (Finmark Trust, 2011). For the household, Finscope considers the respondent's decision-making power, the fact that they hold their own money, and the structure and assets of the household. At the community level, the availability of infrastructure, connectivity and financial products and services are considered. The *FSD-FinAccess* surveys are similar to the *FinScope* surveys but are not conducted by Finmark Trust. Instead, they are conducted by FSD Africa.

Conclusion

In this paper, we analyze the influence of financial inclusion on the probability of business creation in a set of six sub-Saharan African countries using micro-data from FinScope and FinAccess financial inclusion surveys. To do so, we use an instrumental variable estimation procedure to address the endogeneity issues suspected in the literature between the two variables. In addition, the study goes further by seeking to identify which of the barriers to accessing financial services (on the supply or demand side) is most related to the likelihood that an individual will commit to borrowing or saving for business creation. To this end, an indicator of supply-side and demand-side barriers to accessing banking services was constructed from responses to the survey data.

Overall, the results reveal positive and statistically significant effects of individuals' use of banking services, formal non-banking services, informal financial services, and mobile money services on business creation in an underdeveloped context. Having access to all of these financial tools increases the likelihood that individuals will save and borrow for business creation purposes. Thus, assuming a very close relationship between entrepreneurship and development, entrepreneurship emerges as a channel between financial inclusion and development and poverty reduction.

On the other hand, the results show that while the financial inclusion goal can be promoted through formal non-bank and informal financial services, one of the best ways to promote economic growth and poverty reduction is to implement strategies

to improve access to bank and mobile money services. Finally, the results show that barriers to accessing banking services are generally a critical issue. Furthermore, while descriptive statistics show that constraints to using banking services are demand-side rather than supply-side, the empirical results reveal that supply-side constraints are the most common constraints that individuals face in starting a business. Thus, while the work of Banerjee and Duflo (2011) has shown that finance is not the only barrier to entrepreneurship in poor countries, many of which are in Sub-Saharan Africa, policies to increase financial inclusion, such as facilitating access to savings, credit, and insurance products, and a regulatory framework that facilitates the entry and diffusion of mobile services, should help achieve more effective financial inclusion. This is especially important as the covid-19 pandemic presents opportunities that could be seized to advance financial inclusion initiatives using digital platforms.

African countries with underdeveloped digital financial services could potentially marshal their resources and introduce appropriate financial regulations since, to date, development partners and central banks have been at the forefront of formulating and implementing strategies to support financial inclusion. There is great potential to leverage the scale of cell phone ownership and internet access to create technological innovations in the financial sector to support entrepreneurship as the engine of job creation and inclusive growth and thus poverty reduction in developing countries.

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