Chapter 8

ADVANCING FINANCIAL INCLUSIVE SYSTEMS FOR THE NEXT DECADE: THE CASE FOR SRI LANKA

By
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"People were poor not because they were stupid or lazy. They worked all day doing complex physical tasks. They were poor because the financial institutions in the country did not help them widen their economic base."

Muhammad Yunnus

1. Background

There is growing evidence that developing financial institutions and financial markets and improved access to finance has a strong impact on economic development, poverty alleviation and economic stability. An inclusive financial system is able to reduce poverty, boost shared prosperity and support inclusive and sustainable development. Theoretical and empirical research has found increasing evidence of the role of finance in economic growth. According to Levine (2005), a well-functioning financial system would remove financial constraints faced by industries and firms and improve access to finance that is required for economic growth. Realising the importance of finance for growth, many countries are pursuing active strategies to develop their financial institutions and markets as well as improving the access to financial services and products for a wider segment of the population, particularly for low-income groups.

Financial inclusion facilitates greater participation by different segments of the population in the formal financial system. A large informal sector can affect the transmission of monetary policy as a large number of economic agents would base their financial decisions independent of the monetary policy actions of the central bank. With increased financial inclusion, the share of households and small businesses in the formal financial sector increases, thereby improving the effectiveness of the monetary policy transmission mechanism.

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Financial inclusion can be broadly defined as the access to appropriate financial products and services at an affordable cost by all sections of society in general and to low- income groups in particular who are underserved or have been excluded from formal financial services. Financial inclusion aims to, broaden the reach of financial services to those who do not currently have access, to deepen financial services for those who have minimal access and to increase financial literacy and consumer protection so that those who are offered financial products can make an informed choice. Financial inclusion could also mean providing access to a broader range of financial products and services to those who currently having access to only basic financial products. The definition and scope of financial inclusion would vary depending on the level of economic and financial development in each country.

It is therefore, important to determine what constitutes an inclusive financial system. Broadly, when examining a financial system and developing a financial system that is inclusive, there are several areas that need to be looked at. Firstly, the products that are available should meet the needs of the poor. Secondly, they should be provided at a reasonable cost. In this regard, financial institutions would need to find ways of making their services more efficient while some of the administrative requirements may need to be relaxed for financial institutions catering to this segment of the population in order to make them more affordable and accessible. With regard to physical accessibility, in the past, this meant ensuring a sufficiently widespread bank branch network. Today, this would entail making use of advances in technology, particularly mobile phones and the Internet to provide a greater reach to the poor. Finally, it is important to ensure adequate protection is provided as this is one of the major impediments to the utilisation of financial services by low-income groups. This would mean developing a good regulatory and supervision framework covering financial institutions that particularly serve lower income segments of the market. Hence, the availability of safe savings products; credit schemes that are designed specifically for the poor and low-income households and enterprises; insurance products to help mitigate the risk of low-income households, farmers and micro small and medium enterprises; convenient payment mechanisms are all required for an inclusive financial system. However, it should be recognised that financial inclusion is not only for the poor. The non-poor for various reasons could also be excluded from financial services. A strategy for financial inclusion should also address this segment of the population.

The paper seeks to assess the current status of financial inclusion in Sri Lanka and to identify the issues and challenges that exist to expanding financial inclusion in the country. Section 2 discusses the financial inclusion and policies and institutions in Sri Lanka. Key indicators of financial inclusion in Sri Lanka are presented in Section 3. Section 4 presents some issues and challenges to advancing financial inclusion and Section 5 concludes.

2. Financial Inclusion Policies and Institutions

At the time of independence, the financial sector was dominated by foreign commercial banks that mainly served the foreign trade sector and the plantations sector in the economy. Consequently, during that period, the rural sector was poorly served. The establishment of the Central Bank in 1950 was a watershed development that led the rapid development of the financial sector in terms of institutions, instruments, services and geographical coverage. Several initiatives were undertaken to expand the outreach of banking facilities and to increase the flow of credit to the rural areas. The nationalisation of the Bank of Ceylon in the 1960s and the establishment of the People's Bank in 1961 led to a rapid expansion of bank branches around the country. The penetration of banking services into rural areas helped promote banking habits among the people. With the liberalisation of economic activity in 1977, rapid changes took place in the financial sector. There was greater participation of private sector in financial activities and foreign banks were once again permitted to establish branches in Sri Lanka. With the establishment of new commercial banks and the expansion of the branch network, banking activity developed and links with the global financial system were enhanced. The introduction of new financial instruments, adjustment of interest rates to reflect demand and supply conditions, relaxation of exchange controls, and permission granted to banks to establish foreign currency banking units (FCBUs) also took place during this period. Together with the developments in banking there has also been a gradual development of other financial institutions and services such as finance companies and specialised leasing companies as well as the development of the capital market. Consequently, a wide network of financial institutions was created to cater to the changing needs of a growing economy.

Although central banks generally do not engage directly in development activities, recognising the need to accelerate development and to create more regionally balanced growth, central banks in developing countries have played a more active role in stimulating economic activity. The Monetary Law Act No.50 of 1949 Section 108(1) contains provisions permitting the Central Bank of Sri Lanka to act as the agent of the government in guaranteeing, issuing or participating in the loans of banking institutions operating in the country. In 1974, the provision was revised permitting the Central Bank to directly guarantee loans, advances or other accommodations to small-scale enterprises by credit institutions operating in the country. The rationale for the inclusion of this role for the Central Bank was that given the stage of development in Sri Lanka at the time of independence, it was felt that there was a need to assist new businesses which may not have the required credit history to obtain financing from commercial banks coupled with the need to develop new and productive commercial enterprises. Over the years, the Central Bank has played a major role in the provision of long-term project lending and in facilitating lending in the regions. In order to better serve areas and activities that were not being adequately paid attention to by the prevailing financial system, the Central Bank established the Development Finance Department in 1974. The main focus of this department was development-oriented finance which entailed the evaluation and facilitation of medium- and long-term project loans mainly for the tourism industry and for exports. The Rural Credit Department was set up in 1981 to promote lending to the rural sector, mainly for agricultural activities. With the expansion of the branch network of commercial banks, particularly during the 1960s and 1970s, the Central Bank established three regional offices to facilitate economic activities in the regions. With the end of the conflict in 2009, two more regional offices were set up in the Northern and Eastern provinces in 2010. Despite the expansion of the branches of commercial banks, there was still a lack of services offered in rural areas. To address this concern, the Central Bank established 17 regional rural development banks (RRDBs) around the country in 1985. Subsequently, some of these institutions were merged to form 6 regional development banks (RDBs). In 2010, these were further consolidated into one Regional Development Bank (RDB). Another initiative of the Central Bank of Sri Lanka to improve financial inclusion has been the setting up a credit and debt management counselling centre to provide advice to individuals and companies on their credit problems and to address issues relating to the denial of access to finance.

Microfinance lending has played a significant role in providing funds to low-income segments of the population and has helped to develop a more inclusive financial service for the poor. The microfinance sector in Sri Lanka commenced in 1906 with the establishment of the Thrift and Credit Cooperative Societies (TCCS) under the Cooperative Societies Ordinance. With the decline of the TCCS, the Central Bank took the lead in initiating various microfinance schemes. The first commercial microfinance scheme, the Small Farmers and Landless Credit Programme ("Isuru"), was launched by the Central Bank in conjunction with the RRDBs in 1991. Several other microfinance projects were also initiated such as the Poverty Alleviation Microfinance Project (PAMP) I in 2000 to improve income levels and social conditions of the poor in project areas. PAMP II was initiated in 2009, focusing on the areas in the Northern and Eastern provinces that were affected by the conflict. The Central Bank has also from time to time initiated special credit facilities in the event of major disasters. "Susahana" a refinance scheme for those affected by the tsunami in 2004 was operated by the Central Bank which provided refinance facilities to PFIs who provided credit to small and medium enterprises in the coastal areas that were directly affected by the tsunami. A further two loan schemes with 100% refinance from the Central Bank were introduced for development activities in the Eastern Province in 2007 and for the resumption of economic activities in the Northern Province in 2009. "Saubhagya" is another credit line that has been initiated for new entrepreneurs and small- and medium-scale enterprises affected by natural disasters. A credit guarantee scheme covering all short-term loans given for cultivation of crops called the New Comprehensive Rural Credit Scheme (NCRCS) was introduced in 1986. The primary purpose of this scheme was to uplift the socio-economic conditions of micro- and small-scale farmers by providing working capital requirements at low cost through interest subsidy and credit guarantees. The government has played a major role in the provision of micro-credit. The Samurdhi Development Programme which commenced in 1995, replacing the former Janasaviya Programe, comprises a large network of Samurdhi Bank Societies through which savings and borrowing of its members take place.

Table 1
Performance of Major Microfinance Institutions - 2012

Microfinance Institute	Total Deposits (Rs mn)	Total Borrowing (Rs mn)	Total Assets (Rs mn)	Total Investments (Rs mn)	Total Loan Portfolio (Rs mn)
Samurdhi Societies/Banks	42,233	87,046	47,323	42,098	84,251
Department of Cooperative Development	76,378	29,395	67,585	20,100	43,350
Department of Agrarian Development	237	184	1,042	359	4,715
Regional Development Bank	54,710	6,078	69,134	11,385	105,870
SANASA Development Bank	18,003	10,337	24,834	3,430	17,919
Total	191,561	133,040	209,918	77,372	256,105

Source: Performance Report 2012, Department of Development Finance, Ministry of Finance and Planning

In the 1980s and 1990s, several local and international NGOs began to engage in microfinance lending. In many of these cases, microfinance lending was done together with the other social and community development activities undertaken by the NGO. The tsunami which hit the country in 2004 resulted in a significant flow of foreign funds into the country, a large portion of which was channeled through MFIs. More recently, commercial banks have also entered the microfinance credit market. The microfinance scheme “Gami Pubuduwa” (Village Reawakening) which was set up by Hatton National Bank in 1988/89, is one of the oldest and largest microfinance schemes conducted by commercial banks. However, to address the low level of credit disbursements to the agriculture sector by formal lending institutions, the government in its budget for 2006, designated the agriculture sector as a priority sector for lending. Accordingly, all licensed banks were mandated to ensure that 10% of their credit portfolio was made to the agriculture sector and if a bank was not able to meet this target, they were to transfer the funds to the Central Bank to be re-loaned to designated sectors. In the government’s budget for 2012, banks were encouraged to set up dedicated SME centres in each district. Accordingly, several SME centres have been established to provide SME entrepreneurs with advisory and financial support.

Considering the distribution of bank branches in the country, around 35% of bank branches are located in the Western Province which is not surprising as the Western Province accounts for around 43% of GDP. However, to encourage the opening of bank branches in the regions, the Central Bank issued guidelines in 2007 mandating that for every bank branch that is opened in the Western Province, two branches need to be opened in the other regions. This has seen the opening of bank branches in the other provinces in the country. After the end of the conflict, there has been a significant rise in the number of bank branches being opened in the Northern and Eastern provinces. Access to financial services has also improved with developments in infrastructure, particularly the expansion of the road network into the rural areas.

Table 2
Banking Density by Province
(No. of Bank Branches)

	2000		2013	
	No.	Share (%)	No.	Share (%)
Province				
Western	930	32.4	1,213	35.4
Central	354	12.3	370	10.8
Southern	401	14.0	399	11.6
Northern	68	2.4	230	6.7
Eastern	101	3.5	262	7.6
North Western	391	13.6	306	8.9
North Central	160	5.6	204	5.9
Uva	192	6.7	186	5.4
Sabaragamuwa	295	10.3	261	7.6
Total	2,872	100	3,431	100

Developments on the technological front have also helped expand the reach of financial services in the country. The introduction of automated teller machines (ATMs), credit cards, electronic fund transfer facilities has played a significant role in increasing banking activity across the country. The digitisation of financial transactions commenced in the 1980s, following the liberalisation of the economy with the introduction of ATM cards in 1986 and credit cards in 1989. On the payments and settlements front, the establishment of the Sri Lanka Automated Clearing House (SLACH) in 1988, helped automate cheque clearing facilities, thus reducing the time taken to clear cheques and thereby improving the efficiency of banking services. The establishment of SLACH was followed by and facilitated by the introduction of the Sri Lanka Interbank Payment System (SLIPS) which is an electronic funds transfer (EFT) system for interbank transactions in 1994. The SLIPS system reduced the use of cheques and is used mainly for small value bulk transactions such as the payment of salaries and utility bills. This was upgraded to an online system in 2010 facilitating T+0 settlement facilities. With the introduction of cheque imaging and truncation system (CITS) in 2006, the time taken for cheque clearing was reduced further. This system enabled cheques in any part of the country to be cleared within T+1 days. This has significantly enhanced the access to finance through retail transactions. The real time gross settlement system (RTGS) was introduced in 2003 to facilitate the settlement of high value and time critical transactions while the introduction of the Scripless Securities Settlement System (SSSS) has helped develop the government securities market and expand securities trading in the secondary market.

The adoption of electronic banking systems such as the Internet banking and mobile phone-based banking has further helped expand banking activities. Banks commenced offering Internet banking products as early as in 1999. The advances in IT and payment systems throughout the country have reduced fees and charges relating to banking services and has helped increase the receipt of foreign remittances through formal banking channels. The Central Bank also granted permission to commercial banks to carry out agency banking through mobile phones. Commercial banks are able to carry out on-the-spot banking facilities such as depositing and withdrawing money and receiving remittances abroad through their agents located around the country. The widespread coverage of the mobile phone network in the country provides an opportunity to further expand the access to financial services even in the remotest parts of the country through the use of electronic retail payment methods such as payment cards and mobile phone-based payment mechanisms. In 2010, the Central Bank commenced licensing service providers of payment cards and mobile payment systems to ensure safe and efficient retail electronic payment systems. At present in Sri Lanka, several mobile payment schemes (e-money) have been initiated such as eZ Cash, eChanneling, eZ Pay. According to a recent survey conducted among urban poor households, the main uses for electronic payment schemes have been for the payment of utility and phone bills, remittances, retail payments, person-to-person fund transfers. However, the penetration of these e-money schemes has been low and the reasons cited were the lack of need, lack of awareness, lack of trust, difficulty of use, availability and affordability. Recognising the enormous potential of these electronic money schemes and the need to protect customer rights and regulate service providers involved in such businesses to ensure the safety of the payment system and the stability of the financial system, the Central Bank issued the Service Providers of Payment Card Regulations No. 1 of 2009 which was subsequently replaced with the Payment Cards and Mobile Payment Systems Regulations No. 1 of 2013.

Policies have been adopted from time to time to strengthen the financial sector. These institutional and legal reforms that have been adopted have contributed significantly to the expansion of financial services in the country. Recognising the vital role played by microfinance institutions in advancing financial inclusion and the need for better regulation and supervision of this sector, the Central Bank has drafted a Microfinance bill. Under the proposed legislation, a Microfinance Regulatory and Supervisory Authority would be created to license, regulate and supervise institutions engaged in microfinance business. The main objective of the legislation would be to ensure that the operations of MFIs safeguard the interest of depositors and customers.

The Sri Lanka Deposit Insurance Scheme was implemented in October 2010 replacing the voluntary scheme that had been in operation since 1987. All licensed banks and registered finance companies were registered as members of the scheme. An insurance premium ranging from 0.1 % to 0.15 % per annum against all demand and time and savings deposits of member institutions except for deposits of the government, directors, management personnel and other related parties, deposits held as collateral against accommodation and dormant accounts have to be transferred to the Deposit Insurance Fund by member institutions. In the event of the suspension or cancellation of a license of a member institution by the Monetary Board, compensation up to a maximum of Rs.200, 000 per depositor would be paid from the fund commencing 1 January 2012.

The Secured Transactions Act which provides for the establishment of a registry for moveable collateral such as machinery and equipment was passed in September 2009 and the Secured Transactions Register was established in 2011 under the Credit Information Bureau. The main objective of this legislation is to promote economic activity by improving the access to credit for small and medium enterprises (SMEs). Under this legislation creditors could give notice of their security interest in the moveable assets of debtors. Thus, creditors could determine if there are prior claims on assets being pledged as collateral and establish priority in terms of interest in the security. This legislation is expected to facilitate the extension of credit secured on moveable collateral, thereby improving access to finance for small and medium enterprises. The weakness of the scheme is that it is currently only a voluntary scheme and hence does not cover all moveable collateral assets. Expanding the coverage of the credit information bureau is another measure that has been proposed to lessen the issues relating to asymmetric information and thereby improving the access to credit.

Recognising that the lack of awareness is one of the key reasons for financial exclusion, the Central Bank has initiated various financial literacy programmes to disseminate information on financial services to various groups ranging from school children to farmers, women, small and medium entrepreneurs, and self-employed persons. Programmes are conducted on topics such as savings habits, budgeting, financial management, using credit wisely and the risk of unauthorised financial institutions. Entrepreneurship development programmes are also carried out to create awareness of the availability of financial facilities and to improve the technical and marketing know-how of entrepreneurs and farmers. De Mel, McKenzie and Woodruff, (2012) find that basic business training significantly improves the returns from credit, providing further rationale for financial literacy programmes as a means of enhancing financial inclusion.

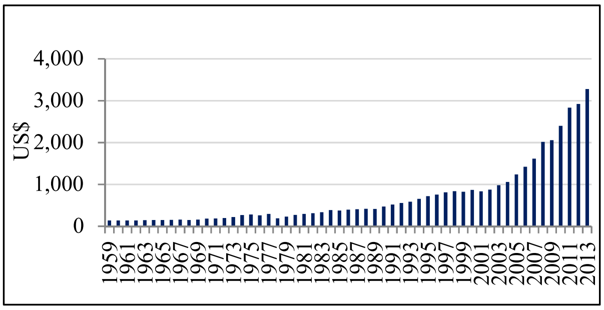
The easing of the monetary policy stance by the Central Bank from end-December 2012 and the steady decline in market interest rates since then, has also created a conducive environment for credit flows. Maintaining a low interest rate environment and favourable macroeconomic conditions will encourage credit disbursements to support economic activity.

3. Current Status of Financial Inclusion in Sri Lanka

3.1 Indicators of Economic and Financial Developments in Sri Lanka

The economy has steadily grown since the country gained independence in 1948. In 1959 when the country first began to compute national account statistics, the per capita GDP at current market prices was US$140. It doubled to US$273 million in 1980 after the liberalisation of the economy. It took more than a decade to double again. Per capita income exceeded US$1,000 in 2004. It thereafter took around 5 years to double to US$2,057 in 2009 and is expected to reach US$4,000 by 2016. Based on the findings of the Global Financial Inclusion Survey conducted by the World Bank in 2011, there is a positive relationship between per capita income and account penetration (Demirguc-Kunt and Klapper, 2012). They find that at per capita income levels above US$15,000 account penetration is almost universal with a few exceptions. However, at per capita income levels below US$2,200, they find that the relationship is much weaker. Sri Lanka, despite being classified as a lower middle income country, has a relatively high account penetration rate of around 69%.

Figure 1
Per Capita GDP: 1959 - 2013



Source: Department of Census and Statistics, Central Bank of Sri Lanka.

The economy in Sri Lanka has undergone a significant transformation since the country gained independence in 1948. At the time of independence, the share of agriculture to total GDP was over 45%. With the liberalisation of economic activity in the late 1970s, the share of the agriculture sector in total economic activity declined to around 30 % and by 2013, this share has declined further to around 11%. The corresponding shares of industry and services sector have risen to around 30% and 60%, respectively. However the share of labour force employed in the agriculture sector continues to remain high at around 30%. In terms of the regional distribution of GDP, the Western Province accounts for the largest share accounting for around 44 % of total GDP. However, the share of the Western Province has declined from 50% in 2006 with the contribution of the other regions gradually increasing.

Table 3
Sectoral Composition of GDP (Percentage)

	1980	1990	2000	2010	2013
GDP					
Agriculture	27.6	26.3	19.9	12.8	10.8
Industry	29.6	26.0	27.3	29.4	32.5
Services	42.8	47.7	52.8	58.0	56.8

Source: Department of Census and Statistics.

Table 4
Regional Distribution of GDP at Current Prices 2006-2012
(Share of GDP %)

Province	Western	Central	Southern	Northern	Eastern	North Western	North Central	Uva	Sabarag -amuwa
2006	50.1	8.8	10.0	2.8	4.9	9.1	4.0	4.3	6.1
2007	46.5	9.6	10.5	2.9	5.2	9.9	4.0	4.9	6.4
2008	45.4	9.8	10.5	3.2	5.6	9.9	4.7	4.5	6.4
2009	45.8	9.8	10.5	3.2	5.8	9.6	4.6	4.5	6.1
2010	44.8	10.0	10.7	3.4	6.0	9.5	4.8	4.5	6.3
2011	44.4	9.8	11.1	3.7	5.7	10.0	4.6	4.5	6.2
2012	43.4	9.8	11.5	4.0	6.3	9.6	4.7	4.0	6.1

Source: Department of Census and Statistics, Central Bank of Sri Lanka.

The financial sector in Sri Lanka has evolved with the changing needs of the economy. At the time of independence, the financial system mainly served the plantation economy. The activities of the financial sector have diversified significantly, thereafter. At present, the financial system in Sri Lanka comprise the Central Bank of Sri Lanka, licensed commercial banks (LCBs), licensed specialised banks (LSBs), licensed finance companies (LFCs), specialised leasing companies (SLCs), primary dealers (PDs), pension and provident funds, insurance companies, rural banks, stock brokers, securities market intermediaries, unit trusts and thrift and credit co-operative societies as well as financial markets, such as the foreign exchange market, money market, and capital market. The financial sector is mainly dominated by the banking sector which accounts for around 56 % of the total assets in the financial sector. The banking sector comprises 22 licensed commercial banks, 2 of which are state banks, 10 private domestic banks and 12 branches of foreign banks. The 6 domestic banks hold nearly 80% of the total commercial bank assets. In addition, there are 9 licensed specialised banks (6 state banks and 3 private banks) engaged in development finance and housing finance activities. Non-bank financial institutions such as registered finance companies and specialised leasing companies also form an important part of the financial system.

Table 5
Total Assets of the Financial System – 2013[(a)]

Financial Institution	Rs bn	Share (%)
Central Bank of Sri Lanka (CBSL)	1,246.0	12.1
Institutions Regulated by the CBSL	**6,872.6**	**66.6**
Deposit taking institutions	**6,594.5**	**63.9**
Licensed Commercial Banks	5,022.2	48.7
Licensed Specialised Banks	919.3	8.9
Licensed Finance Companies	653.0	6.3
Other Financial Institutions	**278.1**	**2.7**
Primary Dealers	213.6	2.1
Specialised Leasing Companies	64.5	0.6
Institutions not Regulated by the CBSL	**2,199.7**	**21.3**
Deposit taking institutions	103.4	1.0
Rural banks [(b)]	94.9	0.9
Thrift and Credit Cooperative [(b)]	8.5	0.1
Contractual Savings Institutions	**1,998.3**	**19.4**
Employees Provident Fund	1,300.0	12.6
Employees Trust Fund	178.5	1.7
Approved Private Provident Funds [(c)]	123.0	1.2
Public Service Provident Fund	36.4	0.4
Insurance Companies [(d)]	360.4	3.5
Other Financial Institutions	**98.0**	**0.9**
Stock broking companies [(e)]	10.3	0.1
Unit Trusts/Unit Trust Mgm Companies	55.8	0.5
Market Intermediaries [(e)(f)(g)]	29.5	0.3
Credit Rating Agencies [(e)]	0.3	0.0
Venture Capital Companies	2.3	0.0
Total Assets	**10,318.3**	**100.00**

Source: Central Bank of Sri Lanka.

Notes:
(a) Provisional.
(b) Registered with the Department of Cooperative Development.
(c) Registered with the Department of Labour.
(d) Regulated by the Insurance Board of Sri Lanka.
(e) Regulated by the Securities and Exchange Commission of Sri Lanka.
(f) Market Intermediaries include Underwriters, Margin Providers and Investment Managers.
(g) Excluding the assets of licensed banks, licensed finance companies and licensed specialised companies which are registered as market intermediaries.

Aggregate indicators such as money supply as a percentage of GDP, financial sector contribution to GDP, private sector credit as a ratio of GDP can provide some measure of the financial depth in an economy. In addition, measures such as stock market capitalisation and outstanding government debt and corporate debt securities as a percentage of GDP give some indication of the development in the financial markets. Based on these measures, we find that Sri Lanka still has a low level of financial depth compared to other emerging nations. Sri Lanka's money supply to GDP ratio is around 40% which is similar to the level in Indonesia (40%) and Philippines (59%) but significantly lower than that of Singapore (138%), Malaysia (142%), Thailand (125%) and South Korea (144%). A similar trend is observed in the ratio of private sector credit to GDP.

Table 6
Selected Indicators of Financial Depth

	1980	1990	2000	2010	2013
Depth - Financial Institutions					
Narrow Money (as a % of GDP)	14.2	12.3	9.4	7.3	5.6
Broad Money (as a % of GDP)	29.9	28.1	32.2	37.3	39.4
Financial Sector Contribution to GDP	3.0	4.6	7.6	8.9	8.7
Total Financial Sector Assets (a % of GDP)	101.7	112.8	129.0	119.38	118.95
Private Sector Credit by Banks (as a % of GDP)	19.1	20.2	29.0	26.6	29.2
Depth - Financial Markets					
Stock Market Capitalisation (as a % of GDP)	n.a.	11.5	7.1	39.4	28.4
Outstanding domestic private debt securities (as a % of GDP)	n.a.	n.a.	n.a.	1.5	0.9
Outstanding government debt securities (as a % of GDP)	14.7	21.1	27.0	42.8	41.8

Source: Central Bank of Sri Lanka.

Although it is recognised that financial inclusion is important for development, identifying the extent of financial inclusion or exclusion in a society has been much harder to assess. The number of bank branches and the geographic distribution of bank branches across the country are some indicators that are used to measure the access to financial institutions. However, mere access to financial services does not necessarily mean that they are utilised. For various reasons, people are excluded from access to financial services. For instance, people who are considered high risk will not be lent to by formal financial institutions. High cost of services, the non-availability of products required by people and the lack of awareness of products that are available are other reasons why people are excluded from financial services. In some instances, people are not comfortable approaching formal institutions to access services for fear of being rejected which leads to exclusion. There are other indicators that are used to assess the type of financial services and products that are available and the extent to which they are utilised such as the number of persons with savings and loans from formal institutions, the use of credit and debit cards and other e-money schemes which would give an indication of the access to payment systems services and the use of insurance products.

Table 7
Access to Financial Institutions

	1980	1990	2000	2005	2010	2012	2013
No. of bank branches & other outlets	632	802	2,876	3,685	4,911	5,416	3,442
Banking Density - No. of commercial bank branches per 100,000 persons	NA	NA	5.7	8.3	11.5	13.4	13.7
Total no. of ATMs	NA	NA	NA	918	2,240	2,390	3,122
No. of ATMs per 100,000 persons	NA	NA	NA	4.25	11	14	NA
Total no. of electronic fund transfer facilities at point of sales machines (EFTPOS)	NA	NA	NA	7,013	27,073	27,689	27,955
Mobile phone banking	NA	NA	NA		184,180	170,394	275,708
Telebanking	NA	NA	NA	766,687	45,196	39,901	34,569
Internet banking	NA	NA	NA		4,264,065	6,972,538	8,942,384
Total no. of credit cards	NA	NA	NA	628,989	778,549	891,170	951,625
Credit Cards per 100,000 persons	NA	NA	NA	3,244	3,770	4,684	NA

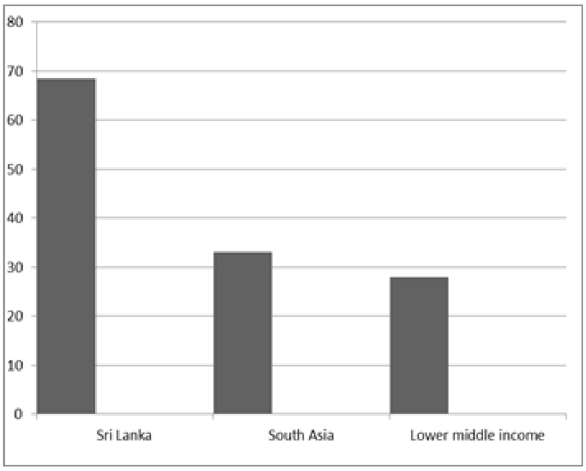
Source: Central Bank of Sri Lanka.

3.2 The State of Financial Inclusion in Sri Lanka Compared to the Region

The Global Financial Inclusion (Global Findex) Database is drawn from a survey of formal financial institutions covering more than 150,000 people in 148 economies representing more than 97 % of the world's population. The last survey was conducted in 2011 and covered around 1,000 people in each economy. The major findings of the study are summarised in Demirguc-Kunt and Klapper (2012). According to the survey findings, despite being categorised as a lower middle income country, Sri Lanka has a relatively high account penetration rate (69%) (see Figure 2) compared to the average for South Asia (33%) and for lower middle income countries (28%). The percentage of those with accounts does not vary significantly between urban (72%) and rural areas (68%). With respect to gender, 67% of adult females in Sri Lanka have an account compared to only 25% in South Asia and 23% in lower middle income countries (see

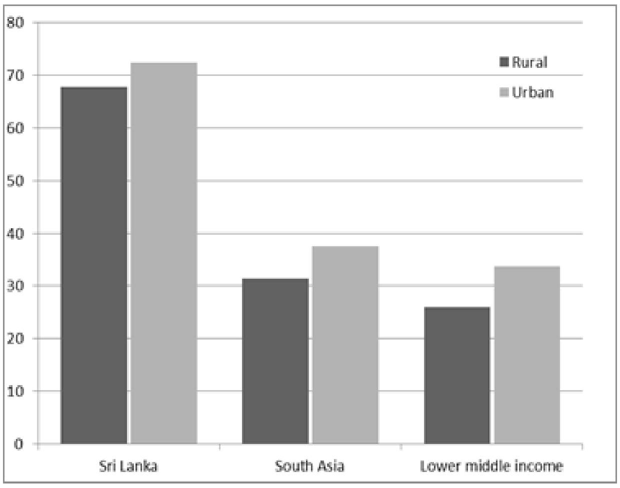
Figure 4). In terms of education, there was not much disparity with 63% of those with primary education or less having an account compared to 76% of those with secondary education or higher (see Figure 5). The disparity was much greater in the case of South Asia with only 28 % of those with primary education or less having an account versus 51 % with secondary or more education. The use of accounts to receive wages, government payments and remittances was relatively low in Sri Lanka as in South Asia and lower middle income countries (see Figure 7). While 28% had saved in a financial institution within the last year, only 18 % had obtained a loan from a financial institution in the past year in Sri Lanka (see Figure 8). Although these rates are relatively low compared to those having accounts, it is still better than the averages for South Asia where only 11% respondents had saved in a financial institution in the past year and only 9% had obtained a loan during the past year.

Figure 2
Adults with an Account at a Formal Institution
Overall (%)



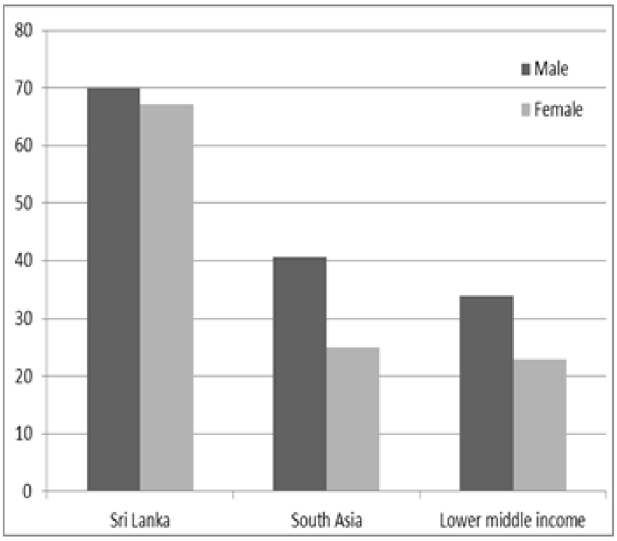
Source: Global Findex Database, World Bank 2013.

Figure 3
Adults with an Account at a Formal Institution by Urban/Rural Residence (%)



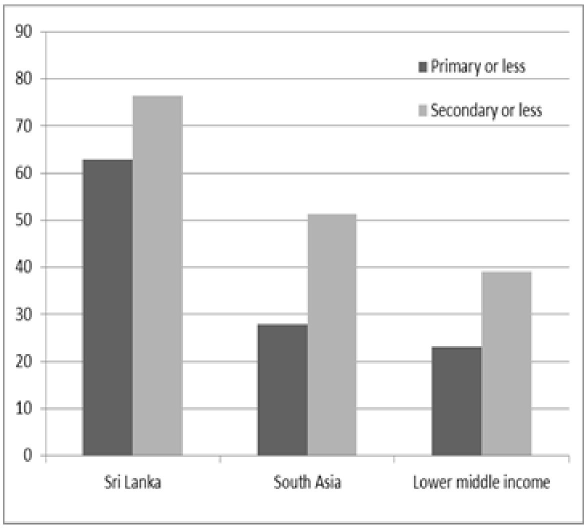
Source: Global Findex Database, World Bank 2013.

Figure 4
Adults with an Account at a Formal Institution by Gender (%)



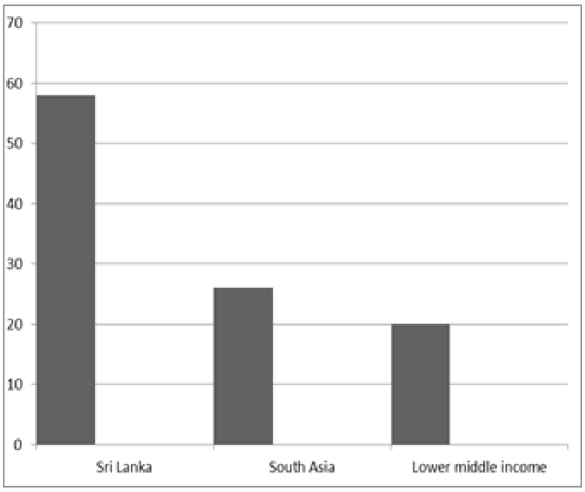
Source: Global Findex Database, World Bank 2013.

Figure 5
Adults with an Account at a Formal Institution by Education Level (%)



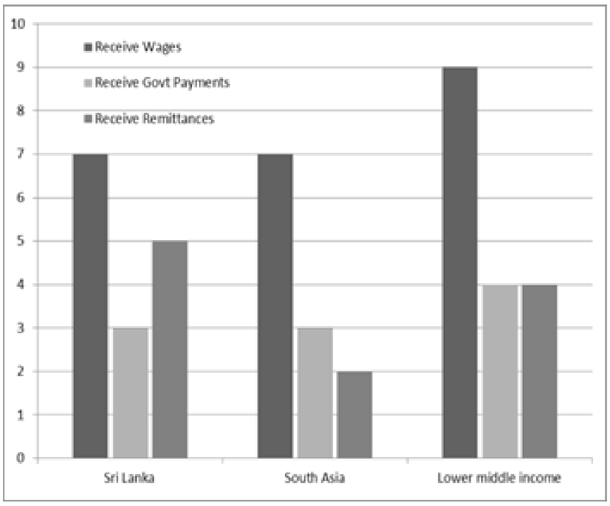
Source: Global Findex Database, World Bank 2013.

Figure 6
Adults with an Account at a Formal Institution Income, Bottom 40 percent (%)



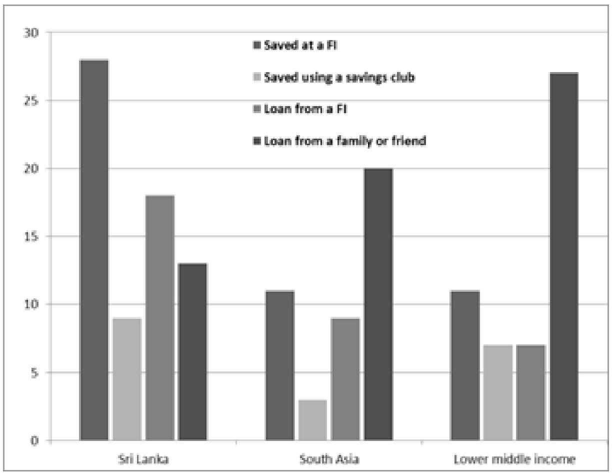
Source: Global Findex Database, World Bank 2013.

Figure 7
Adults with an Account at a Formal Institution
Use of Accounts (%)



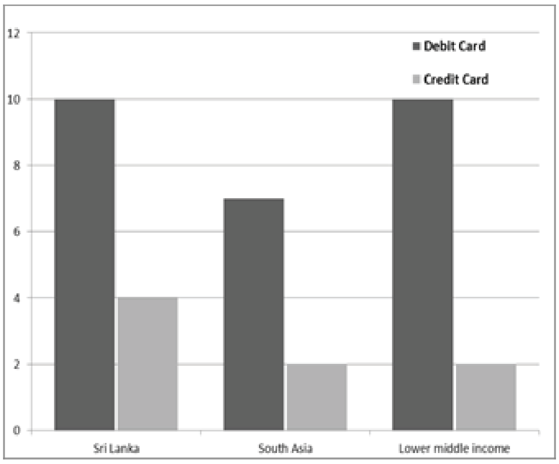
Source: Global Findex Database, World Bank 2013.

Figure 8
Savings and Loan Information (%)



Source: Global Findex Database, World Bank 2013.

Figure 9
Debit and Credit Card (%)



Source: Global Findex Database, World Bank 2013.

3.3 The State of Financial Inclusion across Regions in Sri Lanka

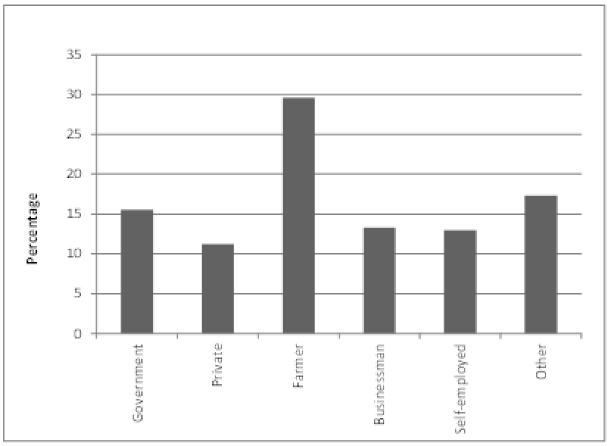
A survey to assess the level of financial inclusion was conducted by the Central Bank of Sri Lanka during the period July to October 2013. The survey covered 1,200 households in six of the nine provinces and 18 of the 24 districts in the country in both urban and rural areas. Unlike the survey conducted by the World Bank, this survey included both formal and informal financial institutions. The survey included 35 questions covering areas such as demographic information, information relating to employment, income and ownership of assets, information relating to interactions with financial institutions including information on savings and access to credit. The survey also collected information relating to the use of Internet, mobile phones and other electronic payment and banking methods. The main objectives of the study were to assess the level of financial inclusion in the regions and to identify the main issues with regard to the access to financial services. The information collected from the survey will be utilised to develop a strategy to improve the level of financial inclusion among all segments of the population and all regions in the country.

3.3.1 Main Characteristics of the Sample Population

The sample comprised 78% males and 22% females. Of those surveyed, 78% were employed while 22% were unemployed. Of those employed, around

30% were engaged in farming, 15% were employed by the government and 13% were engaged in business and another 13% were self-employed, while 11% were employed in the private sector (see Figure 10).

Figure 10
Type of Employment

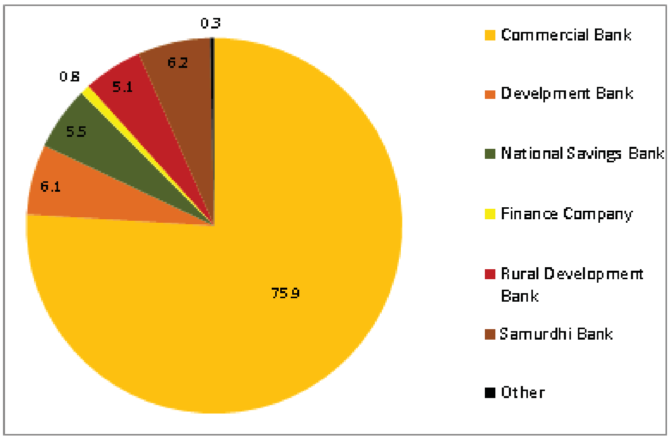


Source: Financial Inclusion Survey 2013, Central Bank of Sri Lanka.

3.3.2 Findings on Access to Finance

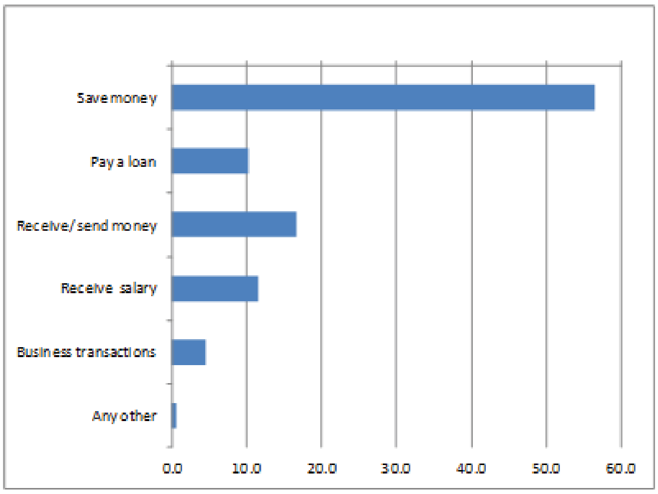
According to the survey, 84% of respondents had an account of which more than 76% were maintained at a commercial bank, 6.2% had deposits at the National Savings Bank (NSB), 6.1% at development banks, while 5% each had deposits with Rural Development and Samurdhi Banks respectively (see Figure 11). Around 70% of those who maintained accounts had deposited money within the past 12 months. The main reason cited by those who had not made a deposit within the last 12 months was that they did not earn sufficient income to save (see Figure 12). This suggests that having a safe place to keep funds was the main reason for maintaining an account.

Figure 11
Type of Financial Institution in which Account is Held



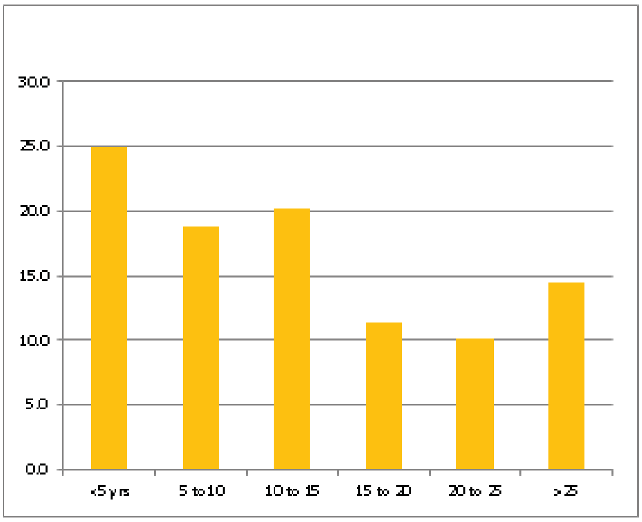
Source: Financial Inclusion Survey 2013, Central Bank of Sri Lanka.

Figure 12
Reasons for Maintaining an Account (%)



Source: Financial Inclusion Survey 2013, Central Bank of Sri Lanka.
Note: Respondents were allowed to provide multiple reasons for maintaining accounts.

Figure 13
No. of Years since Opening an Account (%)



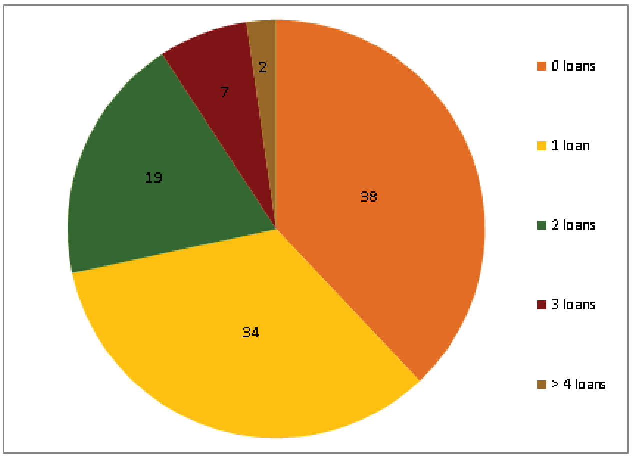
Source: Financial Inclusion Survey 2013, Central Bank of Sri Lanka.

3.3.3 Findings on Access to Credit

Data from the Household Income and Expenditure Survey 2009/10 conducted by the Department of Census and Statistics was used to examine the indebtedness of households. The sample of the survey covers 22,581 households in all districts excluding Mannar, Kilinochchi and Mullathivu districts in the Northern Province[2]. The survey collected information on the indebtedness of households to formal financial institutions such as banks and finance companies and informal arrangements such as loans from money lenders, retail outlets etc. According to the findings of the survey, 62% of respondents had obtained a loan of which 54% were from banks and finance and leasing companies (see Figures 14 and 15).

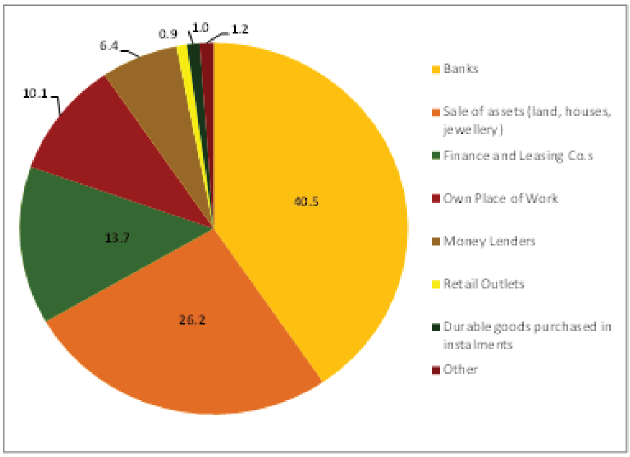
2. For more information on the sampling methodology please refer the Household Income and Expenditure 2009/10 Final Report, Department of Census and Statistics, Sri Lanka.

Figure 14
Access to Credit (%)



Source: Household Income and Expenditure Survey 2009/10.

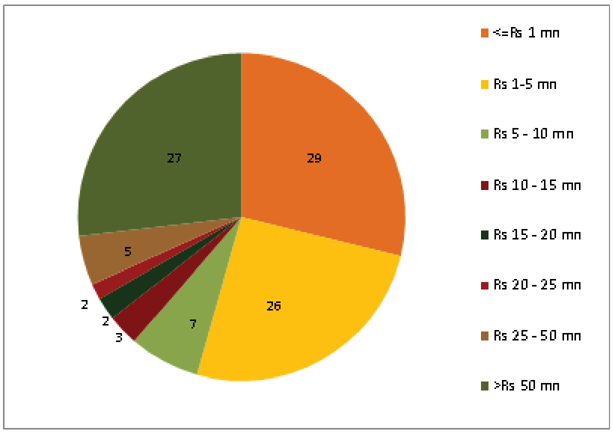
Figure 15
Source of Loans Obtained (%)



Source: Household Income and Expenditure Survey 2009/10.

A breakdown of credit outstanding from the formal sector which includes commercial banks, specialised banks, finance companies and leasing companies is given in Figure 16. Around 29% of total outstanding credit comprises loans that are less than Rs. 1 million and 26% are loans that are less than Rs. 5 million indicating a large proportion of loans fall into the small and medium categories.

Figure 16
Breakdown of Outstanding Credit by Size of Loan as at 30 November 2014(%)



Source: Credit Information Bureau.

3.3.4 Findings on Use of Electronic Forms of Banking Facilities and Payment Schemes

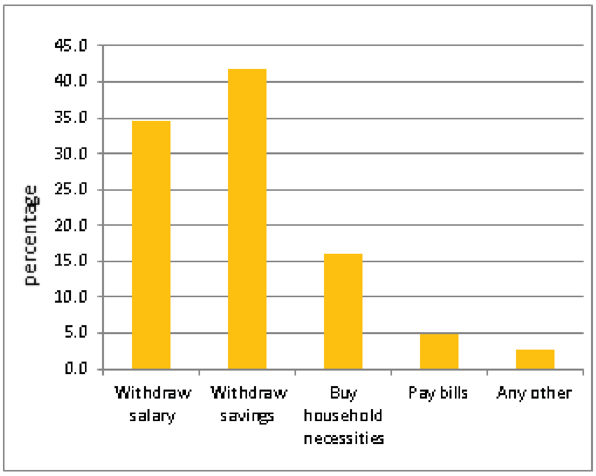
The level of usage of electronic forms of banking schemes and payment methods was relatively low in the households sampled (see Table 7). Only 31% of households that responded had an electronic card, of which the majority was a debit card (84.5%). A very small share had a credit card (15.5%). The main purposes cited for using electronic cards (see Figure 17) were to withdraw savings (41.9%) and salary (34.5%).

Table 8
Use of Technology for Money and Banking Purposes

	Yes	No
Use of electronic card	30.7	69.3
Use of Internet banking facilities	1.6	98.4
Use of mobile phones to send/receive money	0.9	99.1

Source: Financial Inclusion Survey 2013, Central Bank of Sri Lanka.

Figure 17
Purpose for Using Electronic Card (%)



Source: Financial Inclusion Survey 2013, Central Bank of Sri Lanka.

3.3.5 Level of Insurance Penetration

According to the World Insurance Report 2012, prepared by Swiss Re, insurance penetration (total premium as a percentage of GDP) which measures the level of insurance activity is only 1.2% in Sri Lanka. This is relatively low given the size of the Sri Lankan economy and in comparison to the average for Asia which is 5.8% and 6.6% for the world. The main reason for the low level of insurance penetration in Sri Lanka is that insurance is considered an instrument for risk mitigation rather than an instrument for savings and investment. The relatively low income as measured by per capita GDP, the availability of free health and the general lack of awareness of the benefits of insurance are some of the reasons for the low level of insurance penetration in the country. Further, insurance density which is the ratio of insurance premiums to the total population was only US$33 in Sri Lanka compared to the average of US$314 for Asia and US$661 for the world.

A direct link between demand for life insurance and interest rates and inflation has been observed. In the 1970s, with the emergence of high inflation and interest rates, the attractiveness of life savings policies declined, lowering penetration rates in North America and Europe, while increasing in Japan.

However, with the decline in interest rates and inflation in those countries in the 1980s, demand for life insurance increased. In relation to non-life insurance, penetration worldwide has steadily increased with the growth in vehicles. The same trends are expected to be seen in countries such as Sri Lanka with the rise in per capita incomes and the decline in interest rates. With inflation and interest rates being maintained at low and stable levels, there is expected to be an increasing demand for alternative savings products such as life insurance. An ageing population will further boost demand for life insurance in countries such as Sri Lanka. Further, with the growth in per capita incomes, the emergence of a rising middle class and increasing wealth is also expected to increase demand for general insurance.

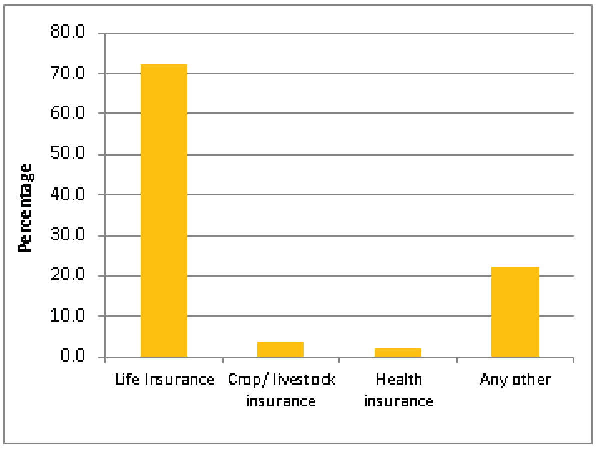
Table 9
Insurance Penetration and Density in Selected Asian Economies

Country	Insurance Penetration[a] (in per cent)			Insurance Density[b] (Premiums per capita US$)		
	Total Business	Life Business	Non Life Business	Total Business	Life Business	Non Life Business
Sri Lanka	**1.2**	**0.5**	**0.7**	**33**	**15**	**18**
India	4.1	3.4	0.7	59	49	10
Indonesia	1.7	1.1	0.6	60	40	20
Malaysia	5.1	3.3	1.8	502	328	175
Philippines	1.3	0.8	0.4	30	20	10
Singapore	5.9	4.3	1.5	3,106	2,296	810
South Korea	12.1	6.9	5.3	2,785	1,578	1,207
Chinese Taipei	18.2	15.0	3.2	3,760	3,107	652
Thailand	4.4	2.7	1.7	222	134	88
Vietnam	1.42	0.63	0.78	22.0	9.8	12.2
Japan	11.0	8.8	2.2	5,169	4,138	1,031
Asia	**5.8**	**4.3**	**1.6**	**314**	**229**	**85**
World	6.6	3.8	2.8	661	378	283

Source: Swiss Re, Sigma 3/ 2012, World Insurance in 2012.
Notes:
(a) Insurance penetration is the total insurance premium as a percentage of GDP.
(b) Insurance density is the ratio of insurance premiums to the total population.

In the survey carried out by the Central Bank of Sri Lanka, around 22.7% of respondents had an insurance policy. Over 70% of the insurance policies taken were in respect to life insurance (see Figure 18).

Figure 18
Type of Insurance Policy Obtained (%)



Source: Financial Inclusion Survey 2013, Central Bank of Sri Lanka.

4. Plan for the Next Decade

The rationale for promoting financial inclusion is not only due to equity considerations; access to affordable financial services is also required for inclusive. Given the important role that financial inclusion plays in realising sustainable development, reducing poverty and boosting shared prosperity, it is necessary to strive for the improvement in the level of financial inclusion in the country. While significant progress has been made towards enhancing the level of financial inclusion in the country as indicated by the various measures of financial inclusion, some areas may need to be strengthened and developed, particularly as the country seeks to graduate to a higher level of per capita income.

4.1 Develop a Formal Strategy for Financial Inclusion

Several initiatives have been taken to promote financial inclusion in the country in past few decades. However, it may be necessary to draw up a formal strategy for financial inclusion to take the country to the next decade. A strategy for financial inclusion may include the following (Financial Inclusion

Strategies Framework, World Bank, 2012): (1) Collecting data to better understand the baseline or starting point in terms of key indicators of financial inclusion that would help policy makers and financial institutions to better design products and delivery mechanisms; (2) Determining objectives and setting measureable targets to be achieved within a given timeline; (3) Developing a strategy or action plan to achieve the objectives and targets set out. A national level taskforce may be set up to coordinate and monitor the implementation of the strategy; (4) Setting out the regulatory and policy actions and the developments to the financial infrastructure that are required to enhance financial inclusion while ensuring the maintenance of financial system stability; (5) Setting up a mechanism to monitor the progress of the strategy and the achievement of the set targets for financial inclusion. This would include the conduct of regular surveys on financial inclusion and evaluation of products and delivery mechanisms introduced to enhance financial inclusion. The findings from these surveys and evaluations would help refine the strategies, thereby improving their effectiveness in enhancing financial inclusion. A strategy for financial inclusion may also seek to focus on some identified priority sectors in the economy, such as SMEs in keeping with the development objectives of the country.

4.2 Establish a Credit Guarantee Corporation

Considering the important role that small and medium enterprises (SMEs) play in the economy, a credit guarantee corporation could be set up to reduce the financial constraints faced by SMEs that do not have sufficient collateral to obtain credit from formal financial institutions. Formal financial institutions are reluctant to extend credit to SMEs for various reasons such as asymmetric information, the lack of acceptable collateral, high administrative costs and the perception that they are high risk. In addition, SMEs are generally not able to provide information on their credit worthiness and often lack appropriate accounting records. As collecting this information can be costly and not cost effective given the typical size of loans to SMEs, formal financial institutions tend to avoid lending to this sector due to problems of adverse selection and moral hazard. Banks are also reluctant to lend to SMEs due to the lack of collateral and problems that arise when trying to register the type of collateral provided by SMEs. The Monetary Law Act contains provisions under Section 108(1) to permit the Central Bank of Sri Lanka to act as the agent of the government in guaranteeing, issuing or participating in the loans of banking institutions operating in the country. To strengthen the role of the Central Bank further, the MLA was amended in 1974 to permit the Central Bank to directly guarantee loans, advances or other accommodations granted to small- scale enterprises by credit institutions operating in Sri Lanka. The Central Bank has operated various credit guarantee schemes covering the agriculture sector and specific industries such as the apparel sector and gems and jewellery sector. Most of the credit guarantee schemes operated by the Central Bank were in conjunction with either a refinance scheme or an interest subsidy loan scheme. However, due to various reasons such as the need for collateral, legal action being taken against defaulters and other stringent requirements, the full potential of credit guarantee schemes has not been realised (de Alwis and Basnayake, 2009). Hence, there is a rationale for establishing a credit guarantee corporation that will encompass all sectors of the economy. According to Basel regulations, the risk weight for lending to SMEs is 75%. However, if these loans are provided with a credit guarantee, the risk weighting assigned would be lower, providing an incentive to banks to lend to this sector.

4.3 Develop Appropriate Products

Financial institutions need to be encouraged to develop products that suit the needs of the poor. The products whether they are savings products, instruments of borrowing or insurance products should be easily accessible and be available at low cost. The literature finds a positive correlation between the access to savings instruments and savings (Ashraf et al., 2010b), investment (Dupas and Robinson, 2009) and consumption (Dupas and Robinson, 2009; Ashraf et al., 2010b). Appropriately designed savings products targeting small savers would encourage those with low incomes to save. Further, in a low interest environment, developing alternative savings products may help ensure that in an ageing society, retirees would be able to enjoy a basic standard of living even after retirement. Further, an ageing society is expected to place additional strain on the public health system. Given the budgetary constraints faced by the government, it would be necessary to develop a comprehensive health insurance system to ease the pressure on the public health system and ensure that everybody has access to affordable medical services. Weather-related insurance to protect the income of farmers from adverse climatic conditions is another area that needs to be encouraged.

4.4 Strengthen the Regulatory Environment

One of the important lessons we learnt from the recent global financial crisis was that financial instability has a disproportionate effect on the poor, as people with low levels of income and savings have less ability to mitigate risk. Hence, countries with low levels of income need to pay special attention to preserving financial stability even as they seek to deepen and broaden their domestic financial sectors, while increasing their integration with the global financial system. Sri Lanka has developed a strong regulatory framework to protect the rights of savers and borrowers in the formal financial system. The establishment of a deposit guarantee scheme; financial literacy programmes are further measures that have been taken to safeguard customers and maintain public confidence in the formal financial system. The informal microfinance sector has also played an important role in providing credit and encouraging savings among low-income persons, thus helping to improve income levels and reduce vulnerabilities caused by unexpected events. However, the large number of microfinance institutions (MFIs) with relatively small capital base has led to inefficiencies and high transaction costs due to the lack of economies of scale. Growth in this sector is not possible without capital while investors and lenders are more comfortable providing funds to regulated entities. One of the barriers to growth in the microfinance sector has been the absence of a single regulatory framework encompassing all microfinance institutions. Some microfinance institutions are regulated under separate legislation and by different institutions. For example, the Regional Development Bank by virtue of it being a classified as a licensed specialised bank is regulated by the Central Bank; the Samurdhi Bank Societies are regulated by the Samurdhi Authority; and the Cooperative Rural Banks are regulated by the Department of Cooperatives. However, a large number of microfinance institutions remain outside the regulatory framework. Since ensuring adequate protection to savers and borrowers is vital to ensure confidence in the financial system and to encourage more participation in the formal financial sector, it may be necessary to revisit the proposed legislation to bring the large number of microfinance institutions into some regulatory framework.

4.5 Develop a Database of Microfinance Borrowers

Financial institutions, both domestically and internationally, have many times been found guilty of over-extending credit to customers. The sub-prime crisis in the U.S. is a good example where policies to promote financial inclusion and reduce income inequalities may have contributed to one of the worst global financial crises (Raghuram Rajan, 2007). This risk is particularly acute in the case of microfinance institutions, due to the availability of a large number of microfinance lending institutions and products. In this regard, credit information bureaus can play an important role by maintaining a database of all outstanding loans to individual borrowers to prevent multiple lending and over borrowing. A database similar to what is maintained by the Credit Information Bureau (CRIB) could be established covering all loans provided by MFIs so that lending institutions are aware of the loans outstanding to individuals before they approve further loans. Issuing directions to MFIs that a single borrower at any given time may obtain a loan from a maximum of two MFIs may also be proposed to curb possible over borrowing by individuals.

4.6 Encourage Secured Transactions (Lending) based on Movables

Several theoretical models find that the availability of collateral is a binding constraint on financing, and it is found to be more severe in underdeveloped financial markets (Liberti and Mian, 2010). Empirical studies have also found that insufficient collateral is one of the main reasons firms are rejected when they apply for bank credit (Fleisig et al., 2006). One of the serious constraints faced by SMEs in Sri Lanka in accessing credit from the formal financial sector is the non-availability of acceptable colleateral such as land and building. Significant default and enforcement risk, double collateralisation of the same asset to multiple lenders and high transaction costs associated with these forms of assets have deterred banks from accepting moveable assets as collateral and significantly increased the cost of funds secured against these forms of assets. Given that movable assets are the main type of collateral available especially to SMEs, the need for establishing collateral registries has been recognised. A collateral registry for movable assets performs two major functions: firstly it informs parties about the existence of a security interest in movable property and secondly, it establishes the priority of creditors. In Sri Lanka, a Secured Transactions Act was enacted in 2009 which came into effect from 1 August 2011. Under this legislation, a lender who offers credit to a debtor on the collateral of a moveable property which belongs to the latter would need to register his ‘security interest’ in this register upon execution of the loan transaction. The creditor, however, does not take possession of the goods but is able to legally enforce his/her security interest over the asset and secures a legal right to dispose of the asset only in the event of loan default. The Credit Information Bureau of Sri Lanka (Bureau) has been entrusted with the responsibility of maintaining a Secured Transactions Register. Currently, registration is only voluntary. However, considering the experience of several countries that have implemented this measure, it may be necessary to insist on mandatory registration of movable assets to ensure that it is effective as a tool for improving the access, particularly of SMEs, to finance from the formal sector (Love, Inessa; María Soledad Martínez Pería and Sandeep Singh, 2013).

4.7 Improve Financial Literacy

Financial literacy is an important component of financial inclusion. All users of financial services, from the financially excluded poor, to the middle income groups and high net worth individuals, everyone who is associated with the financial system needs to be financially literate, albeit to different degrees and in different aspects. In the case of the financially excluded poor, it may be necessary to address the barriers for participation in the financial system. In the case of the middle class, it may be necessary to improve awareness about the financial market and the availability of alternative savings and investment products. While most would be operating a bank account, their participation in the capital market may be very low on account of their lack of knowledge. Financial literacy, in this case may need to focus on creating awareness about the capital market and the ability for the equity investments to provide relatively higher returns compared to other investments, over a longer time horizon, particularly in a low interest rate environment. Apart from the Central Bank and the government, civil society and all other stakeholders also need to get involved in the task of advancing financial literacy among all segments of society.

4.8 Maximise the Use of Technology

Advancements in information technology (IT) have played a role in the development and growth of the financial sector in Sri Lanka. Improvements to the payments and settlements system, such as introduction of automated RTGS systems and Cheque Imaging and Truncation systems have helped improve the efficiency and speed of the payment system. The receipt of remittances through various money transfer systems has also been enhanced following the advancement of IT systems in the whole island. The facilitation of payment cards, mobile phone-based payment systems as well as electronic money system is also expected to ensure a fast, safe and efficient payment system. The role of technology in advancing financial inclusion is well documented. IT can be used to develop comprehensive and reliable credit information systems which are vital for efficient credit delivery and credit pricing. IT can also be used to develop products that are tailored to particularly segments of the population and to reach, particularly, underserved areas. IT can also play a significant role in educating customers through the dissemination of information. Leveraging on the power of IT and optimising the use of the existing financial infrastructure would be necessary to increase the level of financial inclusion going forward. The introduction of a Common ATM Switch (CAS) in July 2013, which is the first phase of a project to introduce a Common Cards and Payments Switch (CCAPS), was an important first step in this regard. This will enable a more efficient and effective utilisation of the domestic ATM network, thereby reducing the cost of domestic transactions as well as the outflow of foreign exchange in the form of charges to international card associations for clearing and settlement of domestic ATM transactions. At present, there are seven commercial banks that have joined the CAS and all banks are expected to join the Switch within a reasonable time. The other phases of the implementation of the CCAPS include the setting up of a Common Electronic Fund Transfer Switch, Common Mobile Switch, Common Shared Switch and Common Point of Sales Switch. The main objective for establishing a CCAPS is to create a single platform for electronic retail payments in the country, thereby facilitating the sharing of payment infrastructure and reducing the cost of transactions.

4.9 Wholesale Funding by Banks to Financial Institutions Engaged in Lending to Small and Medium Enterprises

Commercial banks should be encouraged to make available wholesale funding to financial institutions engaged in microfinance activities so that they could on-lend those funds to segments of the market that are outside the reach of commercial banks. The responsibility for loan appraisal, operating and maintaining accounts will be carried out by the microfinance institution. This would provide financial institutions that are lending to SME with access to low cost funds. Since there is a risk that this could expose the banks to over financing in the sector, banks could be encouraged to lend by way of consortiums.

5. Conclusion and Policy Recommendations

Sri Lanka’s progress in relation of financial inclusion has been impressive. Since the 1950s, the Central Bank and the government have undertaken various policy measures to enhance the level financial inclusion in the country. The growth of formal financial services has been impressive during the past few decades. Based on accepted measures of financial inclusion such as account penetration and access to credit, Sri Lanka has achieved a high level of financial inclusion for a country categorised as a lower middle income country. In relation to other measures such as the use of electronic forms of payment and the uptake of insurance products for health care and agriculture, there is still room for improvement. Policy interventions together with the improvements in income levels are expected to broaden and deepen the financial sector and result in further improvements in financial inclusion in the country.

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