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Financial Inclusion in Russia: Challenges for the Promotion of Long-Term Savings and Investment

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Abstract: The purpose of this study is to shed light on the crucial role of financial education and financial inclusion in overcoming the chronically low level of long-term investments in the Russian economy. By providing a short overview of recent developments on financial inclusion in Russia, we will demonstrate that despite relatively moderate progress in promoting financial inclusion, there remain significant challenges for the government. Territorial discrepancies in the distribution of financial products and services persist across Russia: Providers of such products and services are mostly concentrated in the western part of the country. The banking sector remains over-segmented with a small number of highly capitalised banks and a large amount of undercapitalised small and medium banks. In addition, the quality of financial products and services remains low together with a generally low level of trust towards the banking sector by the Russian population. Moreover, it seems that some individuals, households, and firms are prone to underestimate potential risks of capital borrowing. Thus, the general level of financial literacy in Russia is insufficient. In conditions of low access to loans for many small and medium firms, the greatest challenge facing the Russian government is how to promote the recognition of importance of long-term savings and investments that are a pre-requisite for further development and modernisation of the economy.

Keywords: Russia, financial inclusion, financial literacy, investments

JEL Classification Numbers: G20, O16, P34

1. Introduction

According to the Global Findex Data collected by the World Bank, 67.4% of the Russian adult population had an account at a formal financial institution in 2014. While this figure has significantly improved from 48.2% in 2011 and slightly surpasses the world average of 62%, it is considerably lower when compared with similar indicators of members of the Organisation for Economic Cooperation and Development (OECD). A very moderate progress has been achieved in other key Global Findex Indicators: The proportion of population that had loans from financial institutions in the past year increased from 7.7% in 2011 to 10.3% in 2014, while 15.5% of the adult population had savings in financial institutions compared with 10.9% back in 2011. The data for 2014 also demonstrates that 53% of Russia's low-income population does not use any financial services and their awareness level about financial products is 10–20% lower compared with the average. Thus, despite the profound support

from the World Bank Group, the Consultative Group to Assist the Poor (CGAP) established under its umbrella, the OECD International Network on Financial Education (INFE), and diligent efforts and initiatives of the Russian government, the Ministry of Finance in particular, financial inclusion in Russia is faced by many challenges.

The following can be regarded as the key policy priorities for Russia in order to promote financial inclusion: (a) increasing financial literacy; (b) increasing account usage; (c) increasing the usage of formal savings; and (d) appropriate use of credit (Buyske, 2015, p. 10). Some of these issues are addressed in the *Guidelines for the Development of the Russian Financial Sector in 2016–18* (Bank of Russia, 2016).

Perhaps, the most difficult task among the above-mentioned policies is the increase in savings rates. Savings are important for individuals and households, as well as firms that can obtain finance after savings are transformed into investments. In 2012, the INFE released a concept note on financial education for long-term savings and investments, where it highlighted the crucial role of financial education in promoting financial inclusion and long-term savings, investments, and pensions. The note underlined that in the current unstable economic and financial conditions, the need for savings and investments has increased. It also discussed the increasing trend of transferring financial risks from governments to individuals and households. This transfer implies that individuals are required to save and invest in order to accumulate sufficient funds to sustain their needs in the future (OECD, 2014).

Needless to say, that the growing need for long-term savings and investments by individuals and households to a great extent might be explained by the scarcity of long-term financing. As highlighted by the World Bank, long-term finance is the core of sustainable economic development (World Bank, 2015). The issue of economic development is particularly important for emerging and transition economies pursuing the goal of constructing market economies and sound financial systems. It is well known theroretically that public participation in long-term pension, insurance, and mortgage schemes is a prerequisite for the development of a market economy, as it helps solve the problems related to retirement savings, social security, health insurance, education, and housing. Lack of financial literacy in understanding these issues negatively affects individual well-being and the economy as a whole (Fedorova et al., 2015).

The purpose of this study is to shed light on the crucial role of financial education and financial inclusion in overcoming the chronically low level of long-term investments in the Russian economy. By examining both theoretical and empirical literatures on financial inclusion in Russia, we will demonstrate that despite relatively moderate progress in promoting financial inclusion, there remain significant challenges for the government to promote the recognition of importance of long-term savings and investments that are a pre-requisite for further development and modernisation of the economy.

This study is organised as follows. Section 2 provides a short literature review on financial inclusion in Russia. Section 3 briefly introduces recent developments in the sphere of financial education and financial literacy in Russia. Section 4 explains the crucial role of financial inclusion and financial

literacy in tackling the chronic problem of low investment rate in the Russian economy. Section 5 concludes the study.

2. Financial inclusion in Russia: A short overview

Financial inclusion is defined as the proportion of individuals and firms having access to useful and affordable financial products and services that meet their needs (World Bank, 2014). As suggested by the G20 Financial Inclusion Indicators (GPFI, 2016), financial inclusion can be measured in three dimensions: (a) access to financial services; (b) usage of financial services; and (c) the quality of financial products and services delivery. These are standard tools for measuring financial inclusion for the purpose of country-wise comparisons that include both supply-side and demand-side perspectives.

Disparities in the level of financial inclusion are generally attributed to various barriers such as the cost of opening and maintaining an account, inadequate savings, lack of physical accessibility to banks, and lack of trust in the banking system (Huefner & Bykere, 2011, p. 2). Below, we provide a short overview of recent developments in the sphere of financial inclusion in Russia from both supply- and demand-side perspectives.

Providers of financial products and services in Russia include the following institutions: banks, the Russian Post, banking payment agents, microfinance organisations, credit cooperatives, insurance companies, mobile network operators, E-money operators, and mutual funds. Financial products and services are provided via three delivery channels: traditional, transitional, and innovative.[1] Despite the remarkable growth rate of transitional and innovative channels of delivery, traditional providers prevail: state-owned Sberbank remains the sole financial service provider in many areas together with the Russian Post (Imaeva et al., 2014, p. 31). In fact, many other providers are state-owned (Lyman et al., 2013, p. 7). Banks are still the most prominent providers of financial products and services in Russia, as Russia is characterised by a bank-based financial system.

The predominant role of banks in providing financial products and services is demonstrated in Table 1, which presents selective statistics evaluating financial access and delivery channels in Russia. The amount of outstanding loans and deposits with commercial banks (as % of GDP) has increased in 2012–15. The growth of lending was prominent even before the global financial crisis in 2008–09; in particular, the supply of financial services increased fivefold during 2007–12 (Imaeva et al., 2014, p. 8).

Although there is a slight improvement in the key Global Findex Indicators, such as the percentage of adult population having an account in, loans from, and savings in financial institutions in 2011–14, these indicators are still far below the OECD average. Table 1 below shows selective statistics on financial accessibility in Russia and demonstrates a slightly divergent picture on financial inclusion: the number of banks and bankbranches is steadily decreasing, causing other indicators of financial accessibility, such as the number of banks per 100,000 people and per 100,000 sq. km as well as percentage of population using ATMs as the main mode of withdrawal, to fall. This trend might be regarded as a negative sign for

Table 1. Key indicators evaluating access to financial services and delivery channels in Russia

Indicator	2012	2013	2014	2015	2016	2017
Outstanding deposits with commercial banks (% of GDP)	31.67	34.61	39.44	46.21	n/a	n/a
Outstanding loans with commercial banks (% of GDP)	38.56	42.62	47.47	48.63	n/a	n/a
Number of banks	978	956	923	834	733	623
Number of bank branches and offices (as of January 1st)	40,510	42,640	43,230	41,598	36,994	33,944
Number of branches per 100,000 adults	38.21	38.47	36.99	32.88	n/a	n/a
Number of ATMs per 100,000 adults	141.96	156.41	185.16	172.97	n/a	n/a
Number of bank branches per 1,000 sq.km	10.50	11.53	13.60	12.67	n/a	n/a

Source: Data on the number of bank branches and ATMs per 100,000 adults and per 1,000 sq.km, and outstanding deposits and loans with commercial banks (% of GDP) are retrieved from IMF Data: Access to Macroeconomic and Financial Data. *Financial Access Survey*. Other statistics are obtained from the Bank of Russia.

financial accessibility in Russia.

As of January 2017, 623 banks were operating in Russia, including many that are directly and indirectly controlled by the state; those with foreign capital participation; large private banks; small and medium-size banks of the Moscow region; and regional small and medium-size banks. The number of banks, bank branches, and offices has been steadily declining since the beginning of 2000s due to stricter capitalisation requirements. Russia is gradually trying to introduce Basel principles; thus, banks lacking sufficient capital are compelled either to merge with larger credit institutions or terminate their operations.

Geographical disparities in banking service accessibility are pronounced. Fifty-seven percent of banks are located in the Central federal district (358 banks), followed by Volga (77 banks), North-West (49 banks), South (38 banks), and Siberian (37 banks) federal districts. Other regions have fewer banks with Far-Eastern (18 banks) and Crimea (5 banks) federal districts being the least representative. The state-owned Sberbank has the highest number of domestic branches in Russia. Concentration in the banking sector is extremely high. For instance, Sberbank accounts for 45% of the total household deposits and the share of top five banks in the total assets owned by the banking sector is about 55%, while the top 200 banks control 97% of the total capital of the banking sector (Table 2).

Idiosyncratic features of the Russian banking sector are its over-segmentation, strong state participation, concentration in large-size banks, a large number of small banks, undercapitalisation of the banking sector, regional disparities in the distribution of banking services, unbalanced revenue structure

Table 2. Shares of different group of banks in deposits and loans (%)

Share in %	Household deposits	Firm deposits	Household loans	Corporate loans	Return on Assets (ROA) (2014)	Return on Equity (ROE) (2014)
State banks	60.4	62.2	57.4	64.2	1.2	10.2
Banks with foreign capital participation (foreign share of more than 50%)	6.6	9.2	15.5	7.7	1.6	11.1
Large private banks	28.2	27.3	24.1	25.0	0.1	1.2
Small and medium -size banks of the Moscow region	2.3	0.8	1.4	1.7	1.1	6.2
Regional small and medium-size banks	2.5	0.6	1.6	1.4	1.6	9.6

Source: Compiled by the author with reference to the Bank of Russia (2015)

(high proportion of revenue from foreign exchange operations), chronic problems with long-term financing, low efficiency, restricted competition, fragmentation of the banking sector and strong dependence on external financial markets, low level of transparency of credit institutions, and offshorisation of the banking sector (Gorshkov, 2015).

Thus, the issues of supply-side financial inclusion are of high priority for Russia. According to Imaeva et al. (2014), despite some positive outcomes of Russia's domestic policy on access to financial services, such as decrease in the number of people not using any financial products and services and rather speedy development of branchless banking (cash-in payment terminals for low-value payments), the problem of physical accessibility to financial services in Russia remains a challenge due to territorial discrepancies in the distribution of financial service provider branch networks. Remote and rural areas are generally not sufficiently covered with many branches of such providers. Reasons significantly impeding physical access to financial products and services include high cost of infrastructure development and excessive regulatory and bureaucratic requirements. Similar conclusions are drawn in Lyman et al. (2013). In addition, financial products are based on the choice of employers or government agencies rather than that of customers themselves: Salary cards, mandatory third-party liability insurance, and health insurance are typical examples of this phenomenon. Thus, the usage of bank accounts by the population is somehow passive: simply having an account does not imply its active usage by customers.

As for the demand-side perspective of financial inclusion in Russia, the most detailed study on the issue is presented by Imaeva et al. (2014) under the supervision of the National Agency for Financial Services (NAFI). The study demonstrated that the low level of financial inclusion is explained by

factors such as low provider reliability and high complexity of the financial products and services; moreover, the proportion of Russian population not using any form of financial services remains high and this trend is especially pronounced for low-income respondents. The study also investigated the usage of credit products (cash loan from bank, credit card, POS credit, car loan, mortgage loan, microloan), cash-based products (salary card, social card, debit card), and savings products (current account, demand deposit, savings account, term deposit, mutual fund) and found that credit products prevail over the savings products, thus causing a problem of over-borrowing, which leads to customer's over-indebtedness. It was also confirmed that shorter-term higher-risk products (e.g. cash loans and credit cards) prevail among credit products, while longer-term products are the least used ones among savings products. For many respondents in the survey, savings were usually viewed as a way to preserve money rather than to earn income.

Despite the existing problems in financial accessibility, which in principle should impede financial services provision, the share of outstanding loans in GDP has been increasing (Table 1). The increase in household lending rate accompanied by conditions of low levels of financial inclusion poses a potential peril to the economy. Government-driven measures for the sound development of the financial system are decoupled by the lack of basic financial literacy skills, low confidence on and awareness about the financial system, and mistrust in the financial system itself. Many individuals and households lack future planning and 30% systematically exceed their monthly available income (Fedorova et al. , 2015).

Barriers to financial inclusion are rooted in low trust or mistrust in financial services providers, insufficient knowledge about the products, and relatively low level of financial literacy. As the matter of fact, customers need simpler, easier-to-understand, and standardised financial products and services (Bank of Russia, 2016b).

3. Financial education and financial literacy in Russia

Being the most important determinant in shaping the financial behaviour of individuals, households, and firms, financial literacy is usually defined as the ability to make informed decisions regarding effective usages of individual financial resources. Financial education and financial literacy produce positive outcomes such as increase in saving and lending rates to the poorest population, and both are essential for the acquisition of basic financial knowledge. Financial literacy stimulates participation of individuals in financial markets, helps arrange retirement plans (Klapper & Panos, 2011), and encourages individuals and firms to be prepared for negative outcomes caused by financial crises and shocks (Klapper et al., 2013). Many governments advocate the promotion of financial education with the ultimate goal of reducing poverty, improving welfare, and increasing stability and soundness of the financial system. Financial literacy is usually measured by conducting surveys with standard questions related to compound interest and monthly interest payment calculations, inflation, and sales discounts.

At present, Russia has a full-fledged national strategy for financial education aiming to improve access

to financial services to broader population segments and promoting financial consumer protection and financial literacy. A comprehensive five-year nationwide financial education programme was launched in 2011 under the umbrella of the World Bank and the Ministry of Finance. The Russian government introduced the Financial Literacy Trust Fund in co-operation with the World Bank and OECD in order to support international research on financial literacy. The financial education programme targets low-income and vulnerable social groups as well as young people and envisages strong and positive social outcomes in the long run, primarily among lower-income population segments (Ministry of Finance of the Russian Federation, 2013).

Nevertheless, the level of financial literacy in Russia remains rather low, which is a significant barrier to financial inclusion in Russia. For instance, Klapper et al. (2013), after examining both financial (having a bank account, using formal bank credit, using informal credit) and real (the experience of a negative income shock, level of spending capacity, availability of unspent income) consequences of low level of financial literacy in Russia, conclude that 41% respondents do not clearly understand compound interest rates and only 46% can answer a simple question about inflation. They also find that financial literacy is positively related to participation in financial markets and negatively related to the use of informal sources of borrowing. It is often stressed that financial products and services offered are too complex for individuals and households to understand.

With the purpose of further financial sector development, in May 2016, the Bank of Russia adopted the *Guidelines for the Development of the Russian Financial Market for 2016–18*, where it again highlighted that financial consumer protection and financial literacy of the Russian population is one of the priority goals. Financial literacy is expected to further promote both general awareness of the financial market and confidence in financial instruments. The Russian government plans to introduce mandatory financial literacy classes and develop training materials and educational programmes in cooperation with the Ministry of Education. In addition, the Bank of Russia aims to promote financial inclusion for small- and medium-sized businesses by providing access to microfinance for new entrepreneurs, developing securitisation mechanisms, and streamlining leasing and factoring payment proceedings (Bank of Russia, 2016b, p. 31). This is particularly important for addressing the issue of trust in financial products and services delivered by providers.

According to OECD (2013, p. 19), the lack of trust in financial institutions is caused by reasons such as lack of confidence that proper financial services will be provided, financial market crises, fear of being cheated, and the way in which financial products are provided. As showed by Iakovleva et al. (2013), this is true for Russia, where mistrust in government initiatives is nurtured by the mentality of the Soviet past and 'leave us in peace' position. Bank loans are considered available but 'expensive'; many individuals, households, and even firms fear of 'living on credit' as a post-Soviet syndrome and prefer relying on family and personal connections in making financial decisions. The study shows that despite the fact that many support programmes for small business exist, many female entrepreneurs do not use them due to lack of knowledge or complex and demanding conditions of using such support. This is

partially explained by the low level of trust in the government and the existence of hostile institutional environments that put excessive pressure on entrepreneurs. In fact, access to loans remains a challenge for many small and medium firms.

4. Financial inclusion, long-term savings and investments, and Russia's modernisation

For Russia, the problem of long-term financing is of particular importance. Russia's financial sector has failed to facilitate optimal domestic investment and modernisation. Companies are forced to self-finance instead of relying on least-cost external credit. Russia's financial market is poorly capitalised, which is reflected in its internationally low share of debt financing to GDP. Stock and bond market, investment, and pension fund activities are limited. Moreover, the banking sector does not adequately service the financial needs of the real sector because of its institutional flaws, high domestic interest rates, and low national savings. The lion's share of the long-term financing is inefficiently provided by large state-owned and directly or indirectly state-controlled banks, while other private banks lack adequate capital and are mostly engaged in short- and medium-term lending. The banking sector's financial resources are too limited to foster vibrant corporate development. In some cases, banks even transfer credit resources to stock and currency markets for speculative purposes (Gorshkov, 2018). An extremely low savings rate caused by low levels of trust in financial institutions is the cornerstone of such imperfections of Russia's financial system.

The Global Findex data confirms Russia's low savings rate: In 2011, only 10.9% of the population aged above 15 years had formal savings. In 2014, this figure reached 15.5%; however, it is significantly below the high-income OECD countries (51.6%). In fact, only 40.7% of Russia's population saved any money at all and only 10% were engaged in formal borrowing. Russians mainly use accounts to receive wages (37.9%) and government transfers (14.1%), and to pay utility bills (12.2%). Moreover, as was shown in Section 2, financial inclusion in Russia is sometimes state-driven and many individuals and households do not 'actively' use financial products and services.

Access to financial services by firms also remains a challenge in Russia despite the fact that long-term financing is provided by a variety of domestic and foreign institutions.[2] Pertinent data on the financing of new fixed capital, which is a pre-condition for economic development and modernisation reforms, are provided in Table 3.

Table 3 shows that new fixed capital formation is funded mostly by equity financing (51.1%). This dependency which prevailed throughout 1995–2015 is unusual. Bank loans traditionally are the most important source of long-term finance, but were surpassed in Russia by state and municipal financing (16.5%), and affiliated companies and financial groups (10.5%). The subordinate role of banks in financing new capital formation is confirmed by related statistics.

While the total amount of domestic credit to private sector was estimated as 40.1% of GDP, the share of bank loans in financing new capital formation in 2015 was only 7.8%, which was even lower than

what prevailed during the crisis period 2008–09 (11.8%). Bank loans provided by foreign banks have also decreased from 3.2% in 2009 to 1.9% in 2015. The amount of financing provided from other sources such as new corporate bonds, stocks, foreign investments remains insignificant. Consequently, Russia's economic development and modernisation is extraordinarily dependent on the magnitude of corporate retained profits, and the willingness of managers to invest in upgrading enterprise plants and equipment.

Table 3. Investments in fixed assets by sources of financing (%)

	1995	2000	2005	2010	2015
Total investments in fixed capital by sources of financing	100	100	100	100	100
Equity (internal sources of financing including retained profits)	49.0	47.5	44.5	41.0	51.1
Debt financing (external (acquired) sources of financing)	51.0	52.5	55.5	59.0	48.9
- bank loans	n.a	2.9	8.1	9.0	7.8
(including foreign bank loans)		(0.6)	(1.0)	(2.3)	(1.9)
- loans and credits from other companies	n.a	7.2	5.9	6.1	5.7
- foreign investments	n.a	n.a	n.a	n.a	0.9
- budget funds	21.8	22.0	20.4	19.5	16.5
- financial resources of affiliated companies and financial groups	n.a	n.a	10.6	17.5	10.5
- issuance of corporate bonds	n.a	n.a	0.3	0.01	1.6
- emission of stocks	n.a	0.5	3.1	1.1	0.5
- other sources	n.a	19.9	7.1	5.79	5.4

Source: Compiled by the author with reference to Federal State Statistic Service data (http://www.gks.ru)

The present structure of financing is to a great extent explained by Russia's financial market architecture. Russia is characterised by a bank-based financial system, which is heavily dependent on bank financing instead of stock and insurance markets, non-government pension funds, and mutual funds. As of January 2017, the share of the total banking assets in GDP amounted to 93.2%; the share of capital (equity) was 10.9%. The share of bank credit provided to the corporate sector (non-financial enterprises) and households in GDP amounted to 47.7% (Bank of Russia, 2017). All of these indicators are low by international standards.

Russia's financial system is distinguished by the following features: the limited scope for individual participation in financial markets; a shift in preferences of the households towards services provided by credit institutions offering both banking and stock market services; and low public trust in financial intermediaries. Russia's investment level is low due in part to high interest rates paid on safe bank deposits protected by the Deposit Insurance Agency. Nevertheless, the share of deposits by households in GDP remains low. In January 2017, it amounted to 28.3%, a figure which is lower than those prevailing in other emerging economies.[3] In addition, the level of investment is low due to a low

household savings rate—in the first quarter of 2015, it amounted to only 13.6% (Bank of Russia, 2016a). Thus, further promotion of financial inclusion and financial literacy in Russia has a decisive role in formation of the investment capacity necessary for economic development and modernisation.

5. Conclusion

The problems related to financial education, financial literacy, and financial inclusion in Russia are complex and require numerous efforts and coordination among policy makers, financial products and services providers, the academic society, and customers including both individuals and firms. The leading role of the Russian government in promoting financial inclusion and financial literacy undoubtedly should be positively evaluated. Selective qualitative and quantitative data on the G20 Financial Inclusion Indicators demonstrates that Russia is on the right pathway: It is gradually shifting from financial exclusiveness towards financial inclusiveness. However, a closer look at the supply- and demand-side perspectives of financial inclusion confirms that significant challenges remain. Territorial discrepancies in the distribution of financial products and services persist across Russia: Banks, as main providers of such products and services, are mostly concentrated in the western part of Russia, particularly in Moscow City and the Moscow region. The banking sector remains over-segmented with a small number of highly capitalised banks and a large amount of undercapitalised small and medium banks. In addition, the quality of financial products and services remains low together with a generally low level of trust towards the banking sector by the Russian population. Moreover, it seems that some individuals, households, and firms are prone to underestimate potential risks of capital borrowing. Thus, the general level of financial literacy in Russia is insufficient.

In this study, we particularly highlighted the fact that financial education, financial literacy, and financial inclusion are essential for overcoming the chronically low level of long-term investments in the Russian economy and showed that there remain significant challenges for the government to promote the recognition of importance of long-term savings and investments that are a pre-requisite for modernisation of the economy. Majority of the population seems to have inculcated no saving habits and is cautious towards financial initiatives of the government and financial products and services providers.

As the result, providers lack liquidity and necessary resources to finance firms (which partially explains the low level of capitalisation of Russia's banking sector and their subordinate role in capital procurement by firms); the amount of financing available is often directed towards speculative purposes. Thus, financial inclusion of firms remains a significant issue. In pursuing the goals of modernisation, the Russian economy, perhaps, should focus more on how to break this vicious circle of 'lack of trust–insufficient savings–low amount of investment'. A systematic development of microfinance and credit cooperation between banking and non-banking sectors is required. Moving towards understanding of a more explicit role of financial inclusion in the process of modernisation is needed.

Notes

[1] Usage of traditional delivery channels implies that customers make transactions through staff of financial institutions such as bank branches, the Russian Post, and cash payments to providers. Usage of transitional delivery channels implies that customers make transactions through equipment of financial institutions, such as ATMs, payment terminal at bank branches, and other payment terminals. Innovative channels in Russia are represented by facilities such as mobile phone accounts, online banking, and E-wallet (Imaeva et al., 2014, p. 31).

[2] Some of the sources of long-term financing include the following: commercial banks and non-bank intermediaries; bond markets; stock markets; institutional investors (insurance companies, pension funds, sovereign funds); hedge funds, venture capital funds, and private capital funds; international capital markets (foreign direct investments (FDI), bank loans, portfolio investments, international syndicated loans for project financing, foreign currency international bond markets); state-owned financial intermediaries (development banks) (World Bank Group, 2015, p. 26–27).

[3] The share of deposits by households in GDP for selected economies in 2012: Chile–47.6%; South Africa–39.9%; Indonesia–33.6%; Mexico–27.5% (Bank of Russia, 2015a, p. 18).

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