

Financial Exclusion (MS number 160)

Andrew Leyshon, School of Geography, University of Nottingham, Nottingham, NG7
2RD, UK

Andrew.leyshon@nottingham.ac.uk

Keywords (10-15)

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Glossary (5-10)

Financial exclusion: the process by which people of low and moderate incomes are directly and indirectly excluded from the formal financial system and denied access to mainstream retail financial services

Financial infrastructure withdrawal: the closure of financial services infrastructure, typically branches.

Prime and sub-prime markets: the standard industrial classification of retail financial markets based on the perceived risk of customers. Prime markets are made up in the main of low-risk individuals and household with good credit record. Sub-prime markets are made up on either low income and/or credit-impaired individuals and households who are deemed higher risk. As such they pay higher prices for the products they are able to access, which are inflated by a *de facto* insurance premium

Financial citizenship: a concept that recognises the significance of the financial system to everyday life and confers a right and ability on individuals and households to participate fully in the economy and to accumulate wealth

Financial literacy and capability: the ability of consumers to manage money, keep track of their finances, plan ahead, choose financial products and stay informed about financial matters.

Synopsis

Financial exclusion can be defined as the process by which people of low and moderate incomes are directly and indirectly excluded from the formal financial system and denied access to mainstream retail financial services. Financial exclusion plays an active part in the geography of poverty because those who experience difficulty in gaining access to formal financial services tend to belong to disadvantaged social groups undergoing multiple forms of social deprivation. Financial and social exclusion are often constituent of one another and the links between financial exclusion and social exclusion have been recognised by policy makers and various policy initiatives have been introduced to promote financial inclusion. Access to mainstream financial services within contemporary capitalist societies is recognised as significant because many economic exchanges are mediated through financial institutions, and the use of cash in contemporary capitalist societies has markedly declined. Without access to the financial system, individuals and households may find it more difficult and expensive to pay bills, while the lack of access to products such as insurance denies them the opportunity to shield against risk. Remuneration for paid employment usually requires a bank account into which wages and salaries are deposited and an inability to participate fully in the financial system has implications for income smoothing over time and wealth accumulation. There are distinctive geographies of financial exclusion at a range of geographical scales. In large parts of the developing world, the majority of the population may be excluded from the formal financial system, whereas in industrialised countries such as the US and the UK it is estimated that around 1 in 10 of the population are financially excluded, concentrated mainly in inner city areas and/or in public sector housing.

Introduction

Research on the geography of financial exclusion emerged out of concern with the equity effects of the financial services sectors upon communities and localities. The origins of work of this kind can be traced back to the 1970s, and the initial forays of David Harvey into the political economy of urbanization, and the role played by finance in reshaping the built environment through the actions of the institutions that approved or denied mortgage funding, as well as the role of realtors and/or estate agents in acting as gatekeepers and managers of urban and suburban residential property markets. This work suggested that some areas of cities were effectively embargoed, or red-lined, a phrase that reflected the practice of drawing a red line around areas on a map within which borrowers and properties were to be denied funding, because they were deemed either to have too high a risk of default or that the quality of the area was such that the that were borrowed against might decrease in value. Research of this kind flourished briefly but petered out in the 1980s only to remerge in the 1990s with a more explicit focus of the issue of financial exclusion.

The catalyst for a renewed interest in such issues was research undertaken on the financial dynamics of the Los Angeles economy. Against a background of the neo-liberal reform of the US banking system and the potent racial politics of the Los Angeles metropolitan area, economists Gary Dymksi and John Veitch sought to illustrate the role of retail banking in the everyday construction of uneven development in the urban environment. The concept of financial dynamics sought to illustrate how retail banks and other credit granting institutions were responsible for the circulation and redirection of capital within urban economies. In short, Dymksi and Veitch argued that financial institutions used their branch networks to gather in savings and funds from a wide population but would lend it out more selectively according to strategies of risk aversion

and profit seeking. Thus, although individuals and households in poorer inner city areas may be able deposit money through branches located in their neighbourhoods – although significant proportions of the population in such areas would have little if no contact with mainstream financial services – there was much less chance of them being granted mortgages and loans for houses purchase and maintenance. Conversely, those individuals and households living in more affluent suburban areas were more likely to be granted access to credit, which means that theoretically they were able to access the intermediated savings and deposits of those less affluent financial customers who were permitted to run current/checking accounts with institutions but were, for reasons of risk aversion, unable to draw down credit. In this way, the inhabitants of more affluent and suburban areas were able, via the intermediation of the financial system, to access funds that not only maintained the market value of properties in such areas – by making purchases possible – but also helped to increase such values by providing funds that paid for the upkeep and improvement of the built environment through maintenance, upgrades, extensions, etc. Similar process of uneven access to credit and debt operated for local businesses too, generating significant spillover effects within the communities effected.

In this way, then, the financial system was seen to play an active role in the deepening of uneven development within urban economies. It did so by making evaluations of the prospects of individuals, households and neighbourhoods which, through the either denying or granting access to credit, can become constitutive of such outcomes as suburban areas flourished through an ongoing process of development while inner-city areas became neglected and impoverished through a downward spiral of urban decline as residents of such areas find it hard to both sell, buy or upgrade property while local businesses may be unable to obtain working credit.

This initial foray into the socio-economic consequences of financial dynamics and financial infrastructure was highly influential in the emergence of a geographical literature on ‘financial exclusion’ in the UK in the mid-1990s. Financial exclusion was understood as a process by which certain individuals, households and communities were denied access to the financial system. This work was immediately concerned with closure of bank and building society branches – financial infrastructure withdrawal – influenced as it was by the material evidence of large numbers of branch closures taking place against the background of regulatory reform and a more competitive retail financial service market. Empirical research on the reorganisation of bank and building society branch networks in Great Britain revealed that the overall number of branches declined by almost one third between 1989 and 2003 (Table 1). During the period 1989-2003 banks closed 36% of their branches. In comparison, the closure rate for building societies – mutually owned organisation owned by and on behalf of their members – was less than half that of banks, with 17% of their branches closing over the period, while the top ten converted building societies – that is, those that bought out their mutuality during the 1980s and 1990s to convert to public limited company status – closed 22% of their branches over the same period. This suggested that shareholder pressure – the requirement of public limited companies to make sufficient returns to maintain share prices and pay dividends to the legal owners of the business – was a major factor in driving branch closures which were closed more vigorously to cut costs and increase profits.

Closures were also found to vary geographically, as firms adjusted their branch networks to spatial variations in markets (Table 2). The average branch closure rate for bank and building society branches for all areas in Britain between 1995 and 2003 was 20 per cent. However, the highest rate of closure – almost 24 per cent – was experienced in

Multicultural metropolitan areas, which included poor inner city areas. Higher than average rates of branch closure were also experienced in areas defined as *Prospering metropolitan*, *Traditional manufacturing*, *Built up areas*, and *Student communities*. Meanwhile, areas that experienced lower than average branch closures tended to be more affluent, and which could safely be described as typically ‘Middle England’: these were *Suburbs and small towns*, *Coastal and countryside* areas and *Industrial hinterlands*.

By the late 1990s, work which focused on the reorganisation of retail financial services branches was also being undertaken in other economies such as Canada and Australia where similar processes of financial infrastructure withdrawal were observed. For example, in Canada, a series of mergers between large banks had a serious impact on rural branch networks; 75% of rural communities in a study of British Columbia were classified as either being ‘moderately’ or ‘highly’ vulnerable to closures according to a Bank Closure Vulnerability Index. Meanwhile, the number of bank branches in Australia declined by over 20 per cent between 1981 and 1998. Such observations seemed to confirm that the wave of bank branch closures sweeping industrialised economies was the product of an international process of learning and adaptation to a set of industrial and organisational conventions of how to manage change within the retail financial services sector. Moreover, the outcomes of such conventions were seen to vary over space and, in particular, according to the nature of the institutional context in which they unfold. Thus, in both Canada and Australia, the existence of a richer and more varied financial ecology – such as a vibrant credit union sector, for example – lessened the impact of bank branch closure compared to economies such as the UK which has a notoriously thin and centralised mix of financial institutions.

As work on financial exclusion has progressed, so the domination of the field by geographers has declined as researchers from other fields have become interested in the

problem. As a result, the understanding of financial exclusion has widened, and it is now recognised that there at least five kinds of financial exclusion. While the earliest geographical studies were concerned in the main with what might be described as ‘access exclusion’ – such as branch closure – it is now recognised that there are at least four additional forms of financial exclusion: condition exclusion (where potential customers are excluded for failing to conform to defined product preconditions, such as failing a credit scoring test); price exclusion (where products are priced out of the reach of some consumers); marketing exclusion (where undesirable customers are avoided by aiming marketing campaigns at potentially profitable socio-demographic groups), and; self-exclusion (where customers do not even apply for certain financial products, either because they have been refused in the past, they assume that they will be denied, or they are unaware of products that they might apply for).

Having outlined the dimensions of financial exclusion, and some of its consequences and effects, the next section considers the wider context within which the social process of financial exclusion has arisen.

Financial Exclusion in context

Financial exclusion is a feature of a new financial landscape that has emerged in many core capitalist countries over the past 30 years or so which, in turn, has been forged by at least two inter-related processes. First, the re-regulation of financial services has been in the vanguard of processes of neo-liberalism which have swept market based economies over the past 30 years or so. Initially, processes of neo-liberalism were associated with the roll-back of the state, as markets were subject to processes of re-regulation to make them more open and competitive. Financial systems in core capitalist economies such as the United States, the United Kingdom and Japan were remade in successive waves of regulatory reform from the late 1970s onwards. The financial

services industry continues to be in the vanguard of ongoing regulatory change. For example, in the UK during the 1980s the Conservative government's neo-liberal programme of regulatory reform dismantled long standing structural forms of industry regulation, which encouraged risk-aversion and ensured that different retail financial markets remained institutionally distinctive, in favor of a more prudential regulatory framework designed to encourage competition. As firms began to enter each others markets in search of market share and profits so the widespread cross-subsidisation of consumers across different financial products was swept away so that each consumer increasingly became evaluated in terms of their potential value to the business. Subsequently, neo-liberalisation has proceeded through new policies by which states have sought to gradually abrogate responsibility for many areas of social life which are now left to the market and to individual and household responsibility. This includes greater financial responsibility, and expectations of higher levels of financial capability. This has had the impact of generating significant new markets for the financial services industry.

Second, the process of neo-liberalization has been accompanied by an empowering of financial markets, which has led some commentators to argue that contemporary life is increasingly subject to a process of financialization. Financialization is seen to have agency at a range of scales, including higher levels of instability within the economic system as a whole, and pressure exerted on corporations by capital markets. However, significantly, the process of financialization also increasingly has equity effects as it works its way through the financial system to connect to individuals and households. In particular, retail consumers are being connected to global financial markets as debt repayments are pooled and securitized to create investment products that are sold to international investment institutions. In turn, securitization, and financialization more generally, has been enabled by rapid innovations in information communication

technologies, developments which have also driven the emergence of telephony and Internet-based retail financial services delivery channels, the centralization of processing tasks, as well as the replacement of traditional face-to-face systems of risk assessment and management with sophisticated, at-a-distance credit scoring systems.

The outcome of these processes of neo-liberalisation and financialization has been the creation of an uneven landscape of financial citizenship. Financial citizenship confers on individuals and households a right and ability to participate fully in the economy and to accumulate wealth. Levels of financial citizenship are uneven, both between and within national economies, and have significant impacts on life chances and upon overall levels of economic development. For example, there are marked divides in the possession of these rights and in levels of financial participation in the UK. At one extreme there is the 40% of the population that might be considered ‘super-included’; they have savings and investments and are becoming increasingly wealthy because of it. These are the idealized financial citizens of the neo-liberal state. Second, there are those that may be considered to be less privileged financial citizens, in that while they are fully inside and included within the financial system, they do not have significant savings or wealth, and while they may have full access to financial products they may have limited assets and be heavily indebted. Finally, there are those that are financially excluded or only partially connected to the financial system; they live in a cash economy, use door-step financial services or mainstream but limited products like basic bank accounts.

Thus, the process of financial exclusion is a product of a broader bifurcation of the market for retail financial services. Socio-technologies such as credit scoring systems enable financial institutions to sort prime from sub-prime customers. Prime financial markets are made up of individuals and households that possess socio-economic and geo-demographic profiles that make them targets of the marketing and financial

strategies of retail financial services firms. These middle and high income customers are actively pursued by retail financial services firms, and may be described as the financially super-included, benefiting from intense competition between institutions for their business. One of the drivers of this strategy is the tendency towards the securitisation of retail financial products, whereby lenders aggregate the loans made to low-risk customers and sell them to investors in international securities markets. Sub-prime customers, meanwhile, have low to moderate incomes and/or financial assets and are either excluded from mainstream financial marketing campaigns for new products or are denied access to services if they apply.

The geography of prime and sub-prime financial markets follows established geographies of income and wealth. Thus, for the most part prime retail financial customers may be found in affluent urban and suburban areas, whereas sub-prime markets are concentrated in areas of low and moderate income, typically in inner-city areas (and in Britain, at least, on public sector housing estates). In the absence of mainstream financial services, which continue to close branches in such areas, a host of specialist sub-prime or ‘fringe’ retail financial institutions ply their trade. They provide similar services to the mainstream but at a much higher cost. It is now possible to identify pronounced financial ecologies, made up of distinctive combinations of markets, customers and institutions which are distributed over space.

Financial exclusion and public policy

Financial exclusion has been recognised by policy makers because of the ways in which it disproportionately affects those of low incomes and can exacerbate problems of social exclusion. Early examples of legislation passed to tackle financial exclusion – although it was not identified as such at the time – include the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA) in the US. The

HMDA was passed in 1975 and requires mortgage lenders to make their loan data publicly available for scrutiny. It makes it possible for communities and activists to determine whether financial institutions are serving local housing needs, helps local government and other officials attempt to attract private investment to areas where it is needed and, significantly, make it possible to identify possible discriminatory lending patterns. The CRA, meanwhile, was passed in 1977 to ensure that banks and other deposit-taking institutions served the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, albeit consistent with safe and sound banking operations. As a result, financial institutions are periodically evaluated according to CRA criteria to ensure that credits needs are being met. In many ways, the HMDA and the CRA remain high water marks of anti-financial exclusion legislation, although even in the US they have not served to prevent the advance of processes of financial exclusion, and have waxed and waned according the political predilections of presidential administrations. Both measures were responses to the problems of civil unrest in US cities in the 1960s that revolved around problems of discrimination and uneven development. A similar policy response took place after the 1992 Los Angeles riots, which saw the growth of a movement which encouraged the growth of Community Development Financial Institutions.

Since the late 1990s, the UK government has pioneered legislation that has explicitly sought to combat financial exclusion. The central tenets of UK financial exclusion policy have been fourfold. First, pressuring banks and leading building societies into offering Basic Bank Accounts, which are stripped down versions of normal current/checking accounts, but without overdraft facilities, specially designed for low income consumers. Second, by lining up the Post Office as a third-party distribution

network in order to take advantage of the fact that has more branches than the leading banks and building societies put together. Third, by seeking to tackle low levels of financial literacy and capability through the promotion of financial education. Fourth, and finally, the government has sought to promote third party lenders, such as credit unions, which in some cases are able to provide community-based alternatives by lending in areas that are otherwise subject to financial exclusion.

However, what is significant about all these measures is that they were market-orientated and sought to avoid any strong forms of government interventions within retail financial services markets. Moreover, in some instances the measures contradicted other arms of government policy. For example, the plan to use the thousands of Post Office as de fact bank and building society branches to compensate for the closure of actual branches may have been a good idea in principle but failed to take into account that elsewhere the government was seeking to turn the quasi-state Post Office into a self-sustaining economic organisation capable of reproducing itself without government subsidy. Thus, in order to cut operating costs, the Post Office embarked upon its own round of branch closures replicating the actions of the banks and building societies for which it was supposed to substitute. Moreover, in an effort to open up new income streams the Post Office signed a cooperative agreement with the Bank of Ireland to develop its own range of branded financial products, thereby putting itself in direct competition with the institutions for which it was supposed to be acting as a third party distributor.

Future Research

The growing amount of public policy attention to financial exclusion will have an important bearing on the kind of work being done in this area. There are initiatives on tackling financial exclusion underway in large numbers of western economies and

increasingly at the level of the European Union. As a result, the volume of policy-related material has increased markedly in recent years, much of it produced by or for government departments, regulatory bodies, commissions and policy review bodies. However, the focus of public policy is towards market-based solutions, based on constructions of individuals as consumers, which tends to exclude more radical or interventionist strategies (see French, Leyshon and Signoretta, 2008).

An area of work that does need urgent attention is a critical re-evaluation of the concept of financial exclusion itself. While initially highly valuable as an idea that drew attention to the ways in which financial marginalisation acts as an agent that helps to produce social deprivation, the exclusion-inclusion binary has steered policy towards producing outcomes that can deliver higher levels of ‘inclusion’. While a worthwhile outcome, it is increasingly recognised that financial inclusion on its own is not necessarily a panacea, and that finer grained and more nuanced understandings of the relationship between individuals and households and financial services markets are required. Ways forward here include the development of concepts such as financial citizenship and financial ecologies, which have the advantage of examining financial markets as a whole, not just the boundaries. These concepts have a better purchase on the relationship between social position and geography in the production of the position of individuals and households within financial markets.

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Table 1: Branch networks of top six bank groups, top 10 ‘converted building societies and top 10 building societies, and, Great Britain, 1989-2003* (Source: French et al, 2007)

	Branches			Change (%)		
	1989	1995	2003	1989- 1995	1995- 2003	1989- 2003
Top 6 Bank Groups***	12,659	10,406	8,077	-17.8	-22.4	-36.2
Top 10 converted building societies****	3,473	3,348	2,702	-3.6	-19.3	-22.2
Top 10 Building Societies**	1,699	1,478	1,403	-13.0	-5.1	-17.42
Total	17,831	15,232	12,185	-14.5	-20.0	-31.7

Table 2: Branch closures and openings by banks, converted building societies and building societies, by Supergroup area, Great Britain, 1995-2003 (source: French et al, 2007)

'Supergroup'	Total branches 1995	Total branches 2003	Branch closures, 1995-2003	Branch openings, 1995- 2003	Net change	Net change (%)
Industrial Hinterlands	1873	1524	479	130	-349	-18.6
Traditional Manufacturing	1677	1303	499	125	-374	-22.3
Built-up Areas	1832	1424	508	100	-408	-22.3
Prospering Metropolitan	1431	1111	480	159	-321	-22.4
Student Communities	1829	1442	579	192	-387	-21.4
Multicultural Metropolitan	1040	795	329	84	-245	-23.6
Suburbs and Small Towns	2651	2209	628	180	-448	-16.9
Coastal and Countryside	2341	1942	497	98	-399	-17.0
Accessible Countryside*	164	128	42	6	-33	-22.0
Total	14838	11871	4041	1074	-2967	-20.0

Further Reading

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List of Relevant websites:

Citizens Advice Bureau: <http://www.citizensadvice.org.uk>

Federal Financial institutions Examinations Council:

<http://www.ffiec.gov/default.htm>

Financial Services Authority: <http://www.fsa.gov.uk/pages/index.shtml>

HM Treasury: <http://hm-treasury.gov.uk/>

Which Magazine: <http://www.which.co.uk/>