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Financial inclusion only when service providers raise awareness

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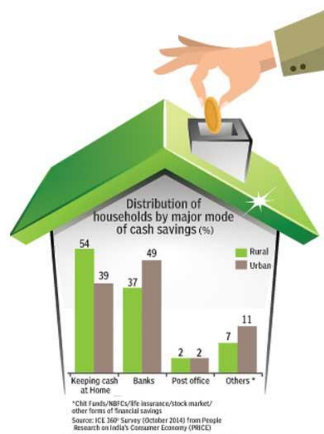
Opening savings accounts can only be the first milestone in the long journey ahead.



The shift in political rhetoric from poverty alleviation to financial inclusion is a subtle but significant change. While previous governments waxed eloquent about eradicating poverty, the current one has focused on the agenda of 'financial inclusion for all'. The launch of the ambitious Pradhan Mantri Jan-Dhan Yojana, under the National Mission for Financial Inclusion, is aimed at ensuring access to financial services by providing a host of benefits including a bank savings account, life insurance and debit cards for all. The objective is to reach out to millions of persons who have until now had no access to formal banking facilities.

The fact that 175 million new accounts have been opened within a year is touted as evidence of the grand success of the scheme. However, the real test should be whether it will translate into securing for an entire generation of Indian households a financial future, whereby they can convert their cash savings into prudent investments and access credit with reasonable debt servicing options. The necessary conditions for success would thus depend on understanding Indians' behaviour towards savings and expenditure, and using these insights to design financial products that will enable consumers to make wise decisions and grow their wealth. The recent ICE 360 Survey 2014 conducted by PRICE provides fascinating insights into these issues and gives us pointers to the challenges that we, as a nation, face towards making true financial inclusion an achievable goal.

A critical step is to understand the manner in which people earn their income. Nearly 41% households (112 million) are self-employed. A significant proportion (33%, or 90 million) is employed as casual labour. One-fifth (54 million) earn regular wages or salaries. Consequently, there would be a great demand for financial services that offer reliable and low-cost sources of working capital, and that allow the self-employed to optimise their inventories, buy productivity or service-enhancing assets with short payback periods. Apart from the fact that the earning potential of these self-employed people is low, they are also constrained by low levels of education. So, any policy that focuses on financial inclusion of this large segment of population needs to find ways to enhance their earning potential by designing an appropriate set of financial products and services. Added to that, steps need to be taken to create a banking services environment that is perceived to be friendly and non-intimidating.

The second critical key to financial inclusion is understanding savings and expenditure behaviour, and the linkages between the two. Household expenditure patterns show that as income levels rise, the spending on food items declines. Even so, at the aggregate level, the proportion is still significant. The other side of

the expenditure story which has an impact on financial inclusion is related to a household's 'unusual' expenditures, i.e. those that is incurred but not on a regular or predictable basis. In India, spending on ceremonies and medical expenses account for almost 40% of unusual expenditure. The proportion of spending on these two activities is even more significant (over 55%) among bottom pyramid households.

Given this spending pattern, it would be valid for financial service providers to look into how they can design products that allow households to meet such expenditure with ease. The health issue lends itself to low-cost insurance solutions and there has been some progress on widening access to health insurance. Complementary inputs such as supply of low-cost healthcare facilities and treatment that can be covered by a mass insurance scheme would go a long way in amplifying benefits of financial inclusion.

Expenditure related to ceremonies—though more complicated than health insurance—also lends itself to innovative financial product design. For example, organised sector employees who benefit from provident fund schemes often enjoy the privilege of withdrawing a substantial portion of the accumulated sum for personal expenses, such as daughter's marriage. This is, in essence, a systematic investment plan. Products of this nature are available in the market and the question is one of threshold contributions and whether these can be lowered to provide access to large numbers of households, even while giving them a reasonable rate of return, so there is sufficient accumulation. This would serve a two-fold purpose: meeting the demand of a large segment of the population and weaning them away from informal sources of borrowing.

This brings us to the third critical component. Most people in India save for emergencies. According to our study, of the 270 million households with at least one earner, about 239 million (89%) reported saving some portion of their income during 2013-14. The propensity to save is a function of ability to save, and it increases with earning capacity. In response to the question posed to chief wage earners—Did you or any member of your household saved money for the future in the last fiscal, 2013-14?—a majority of rich CWEs (top 20% households) confirmed they had saved and invested. The rate declines for the lower quintiles and is least for those at the bottom of the pyramid. The top four reasons attributed for saving are—having cash available for meeting contingencies, old-age security, medical emergencies, and for children's education. The trend is fairly similar across all income quintiles, but what is noteworthy is that earners from households with lower levels of income are perhaps less inclined to set aside hard-earned cash for old-age security (their need for liquidity is more immediate) as against those at higher levels of income who can afford to apportion a part of their earnings to long periods of lock-in.

The survey revealed that most households prefer to have cash liquidity for emergencies. But with rising incomes, savings accounts and terms deposits are preferred. Together (cash at home and banking instruments), they constitute the most preferred savings/investment mode for a majority of households that saved in 2013-14. While one may argue that high liquidity is a wise decision when it comes to planning for unknown financial shocks, but keeping money in a savings account is neither going to create sufficient wealth to meet old-age requirements nor will it help meet rising tuition fees for children's education. Holding them in immovable assets or gold or financial securities makes more financial sense than having liquid cash or savings accounts.

There is a need for launching awareness about financial instruments on a massive scale. Banking services too need to change their outlook towards lending. The survey results indicate that while 29 million households have some outstanding debt with a bank, as many as 50 million households borrowed from informal sources to meet their financial requirements. For financial inclusion strategies to succeed, opening up of savings accounts can only be the first milestone in a long journey ahead. It's for banking

service providers to recognise the opportunities in transforming today's neo-financial-literates into potential lucrative financial clients of tomorrow.

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