Financial risk continues to dog Indian households

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We need to step up financial literacy levels, offer comprehensive solutions to meet customer needs, and help agent advisors graduate to financial planners.

Financial inclusion is the buzzword that has found favour with successive governments. According to official figures, the current government's Jan-Dhan Yojana has resulted in increasing the number of bank accounts by more than two times, from 68.7 million in October 2014 to 169 million in July 2015. Affordable personal accident and life insurance cover also figure prominently among the government's initiatives. Given these impressive numbers, can we say that India is finally headed towards a new phase of improved financial literacy and inclusion?

Before we get to answering that question, let's consider surplus income or the amount left over after deduction of routine and non-routine expenditures incurred by a household. The surplus income as a share of total income, which is an indicator of the savings rate, has been estimated at 18% at the all-India level for the financial year 2013-14. At an aggregate level, there is not much difference in the share of surplus income to total income across both rural and urban India. However, it varies considerably across the four urban clusters and three rural clusters. At the all-India level, the average annual surplus income was estimated to be R35,100 per household in 2013-14. While the surplus income of an average household in rural India is much lower at R27,633, it is 80% higher in urban India, at R49,896.

Across all households, the most important reasons cited for savings are to meet contingencies (25%), old age security (25%), medical emergencies (19%) and children's education (15%). The most preferred mode of savings continues to be bank deposits. Informal modes of savings such as keeping cash at home and keeping money with lenders are also perceived as important methods of savings by Indian households. More than two-thirds of households (68%) reported keeping cash at home as one of their top three modes of savings. Life insurance (29.7%), fixed deposits (16%) and postal savings (12%) are among the popular formal saving modes. Other instruments such as chit funds/NBFCs, public provident funds (PPFs) and shares/mutual funds are cited in the top three modes of savings by less than 5% of the households each.

Clearly, then, keeping cash at home and in a savings bank account do not translate into a positive answer to the question of improved financial literacy. These are, at best, short-term measures of dealing with contingencies. Ownership of life insurance products, which is considered to be the most effective risk-mitigation tool the world over, has not seen huge growth among Indian households. Ten years ago, only 24% of Indian families owned life insurance. That figure has marginally improved to 30%. While urban households are more likely to own life insurance policies (43%), less than a quarter of rural households (23%) do so.

Life insurance ownership continues to be influenced by factors such as location, education and income levels. For instance, nearly 45% of households that own life insurance policies are to be found in metro cities. Boom towns, niche cities and other urban towns too have a high concentration of life insurance owning households (between 42-43%). However, in rural areas, this percentage dips to 33% in developed rural and 30% in emerging rural. Just about 16% households in underdeveloped rural own life insurance policies. Similarly, nearly half of graduate-plus households own life insurance against just 19.4% and 10% in the case of primary-schooled and illiterate households.

Salaried households, which are the top-income earners, are also more likely to own insurance products (50.5%). Nearly 38.2% of households who earn their income from self-employment in non-agricultural activities and 26.5% of those who are self-employed in agriculture have life insurance. In contrast, only 15.1% labour households do so. The proportion of insured households steadily rises with income—from 16.7% for bottom of income pyramid (Q1) to 48.3% for the highest income group (Q5).

Those who are relatively more affluent are the ones who are investing in risk mitigation. The average income of an insured household is R2,86,000 compared to the non-insured household's R1,60,000. Average expenditure levels are R2,25,000 for an insured household versus R1,34,000 for a non-insured household, and the surplus income figures are R61,000 versus R26,000, respectively. Households that are financially vulnerable continue to be at risk.

Despite the fact that life insurance products are routinely advertised especially across TV channels, financial literacy is still to take hold among Indians. Most families—in urban and rural areas—are financially vulnerable in the absence of any insurance coverage and yet they have an optimistic outlook. An overwhelming 43% of chief wage earners are confident about their financial stability. The government, private sector, NGOs and other stakeholders must work towards making India a financial secured nation.

The financial vulnerability of Indian households, the spending and borrowing habits of Indians, their perceptions about financial security, and the misconceptions pertaining to life insurance all point to the need for taking corrective measures. While governments have a role to play for poor households, the general financial security largely remains the responsibility of each household. Therefore, the need of the hour is stepping up financial literacy levels, offering comprehensive solutions to meet customer needs, and helping agent advisors graduate to becoming financial planners. The lack of reach of financial instruments—especially life insurance—to an overwhelming majority of Indians also points towards a huge opportunity, waiting to be tapped. The industry needs to evolve innovative distribution channels and products that would suit the largely under-insured rural markets of the country. The industry also has to develop products that suit the specific needs of women.

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