

Financial inclusion in India

**Why distinguishing between access
and
use has become more important**

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Recent Efforts

- The Jan Dhan Yojana (JDY) was launched on August 28, 2014
- 1.5 crore bank accounts opened on a single day
- Signalled accelerated efforts by the government to make financial inclusion a key goal to change lives, reduce risks, and make a broader section of the population a part of the growth process
- But is this enough?

Structure of Presentation

1. Financial services: Access and use
2. Are we reaching the targeted groups?
3. The supply side: Policy and infrastructure
4. The demand side: Factors determining the use of financial services
5. What can we learn and what are the challenges ?

Financial Services: Access and Use

Rangarajan Committee (2008)

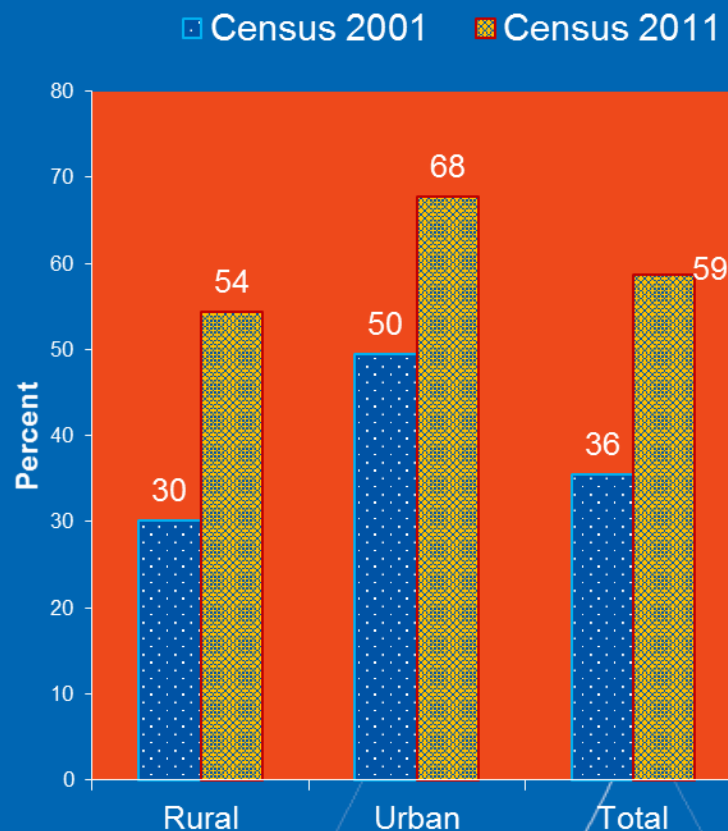
Financial inclusion defined as universal access to financial services by the poor and disadvantaged people at an affordable cost

Over the past decade, the transaction costs to provide financial services have fallen both due to using newer technologies like mobile banking, as well as a shift towards a more innovative delivery strategy of using Business Correspondents (BC)

Financial Access

- In India, by the very definition of financial inclusion, the focus of the rhetoric has primarily been on access to financial services according to a set of various indicators
 - Percent of households having a bank account
 - The number of bank branches per 100,000 population
- Substantial improvements have been made in improving financial access
 - Between 2001-2011, bank accounts in rural areas increased by over 80%
 - During the same period, bank accounts in urban areas increased by a relatively modest 37%
- Overall, in 2011 almost 60 per cent of households in India had access to credit.

Households Availing Banking Services



Source: Department of Financial Services, GOI

Use of Financial Services

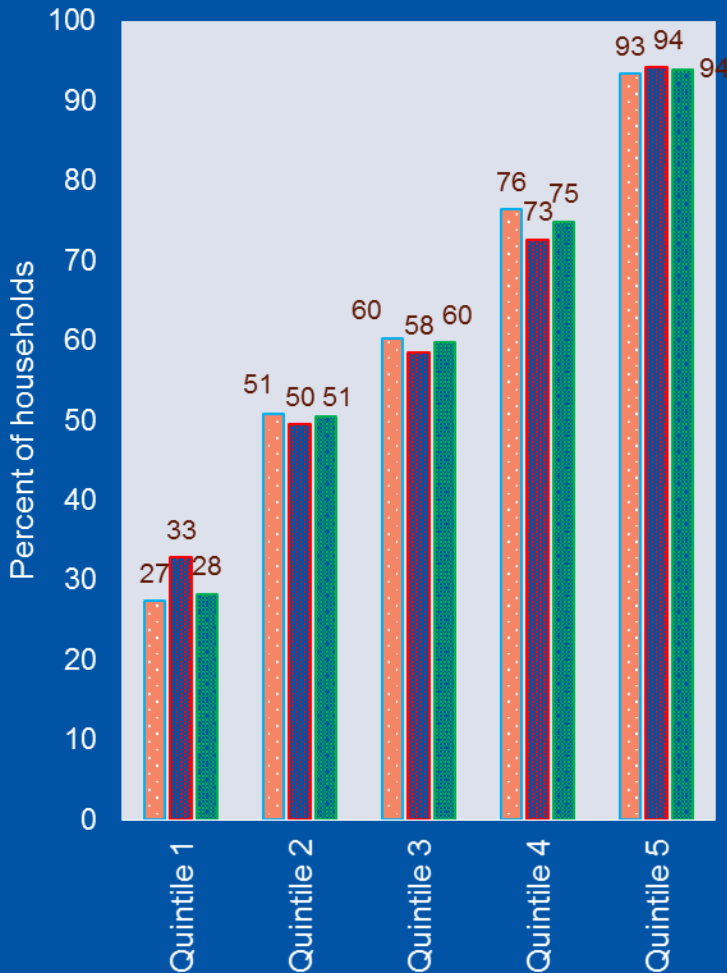
- World Bank's Global Financial Development Report (2014)
 - Only 11% of those who had a bank account made savings and only 8% took loans.
- Vast number of dormant bank accounts
 - The RBI 2011–12 Annual Report : Almost 75 per cent of savings accounts lie dormant
 - Surveys by InterMedia (2013–14) and Microsave (2012): Almost 80 to 96 per cent of bank accounts opened by BCs in rural areas are dormant
- If financial inclusion is to ultimately translate into ensuring that the poor and the disadvantaged have affordable credit to smooth consumption and reduce risks, then of equal if not greater importance is to look at not just access to financial services but use of such services on a long term basis.

2 Are we Reaching the Targeted Groups?

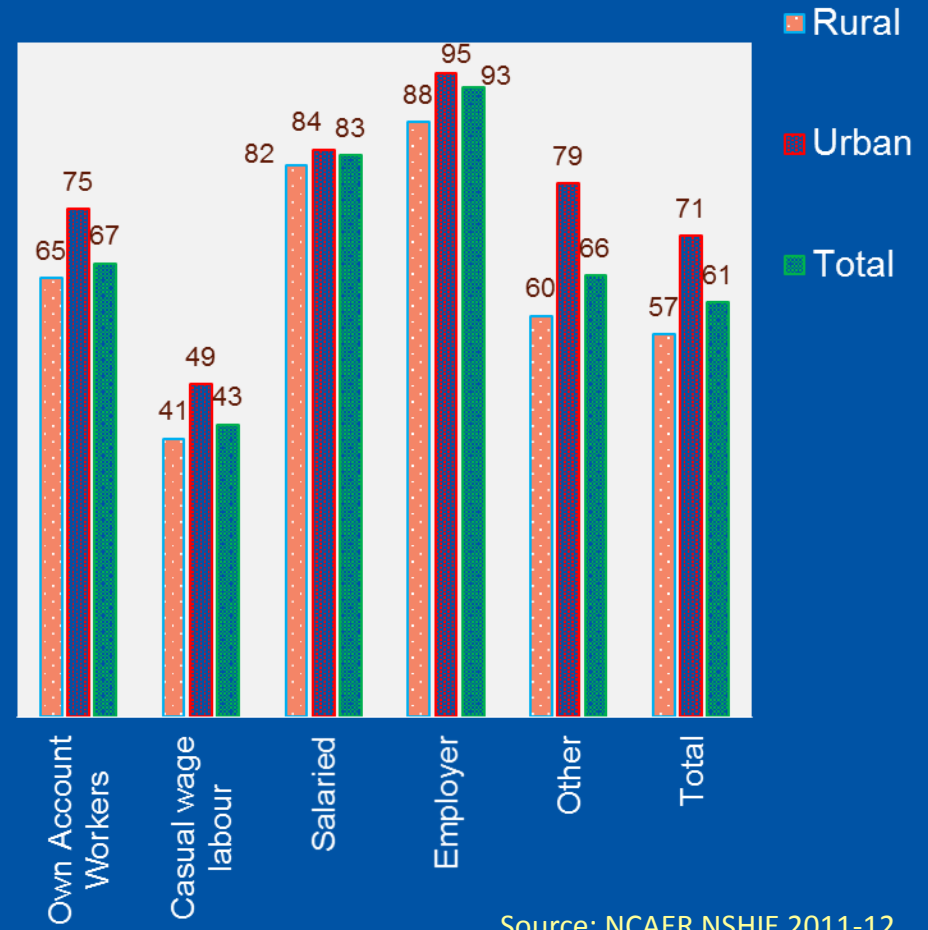
- The most underserved are those in the greatest need for financial services – the bottom 40 per cent
- The NCAER-NSHIE 2011–12 survey indicates that on average, less than 30 per cent of those in the bottommost quintile have a bank account, and about 50 per cent of household falling in the second quintile have bank accounts.
- It is also seen that the lack of financial access is the largest among the casual wage labourers, with only about 40 per cent of the casual wage labour having a bank account.
 - However, a large fraction of these accounts are only used to withdraw payments from MNREGA into these accounts
- For the most part, the rural poor have to rely on informal sources of finance for credit.

Per cent of Households having Bank Accounts

Percent of households having bank account by quintiles



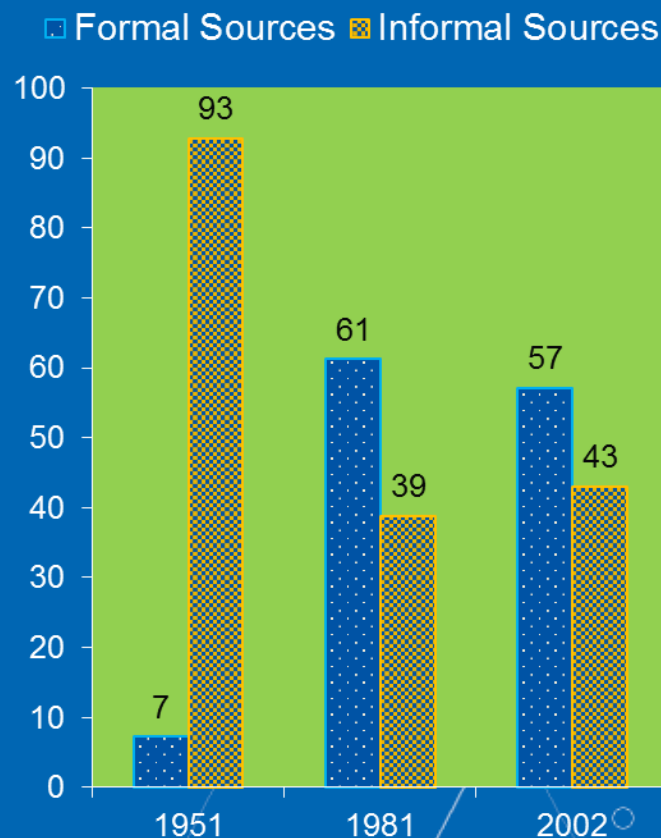
Percent of households having bank account by the occupation level of chief wage earner



The Rural Credit Market

- Formal sources of credit increased from 7% in 1951 to 57% in 2002
 - However, limited access to institutional credit by the small and marginal farmer who own more than 80 per cent of the agricultural holdings
- As per the NSSO data, farm households not accessing credit from formal sources is especially high at 96 %, 81 % and 78 % in the North Eastern, Eastern and Central Regions respectively
- These numbers are staggering
 - Shows that even if on average 54% of rural household have a bank account (2011 Census), the actual purpose of more inclusive access is not translating to affordable credit for the poor.

Sources of Credit in Rural India

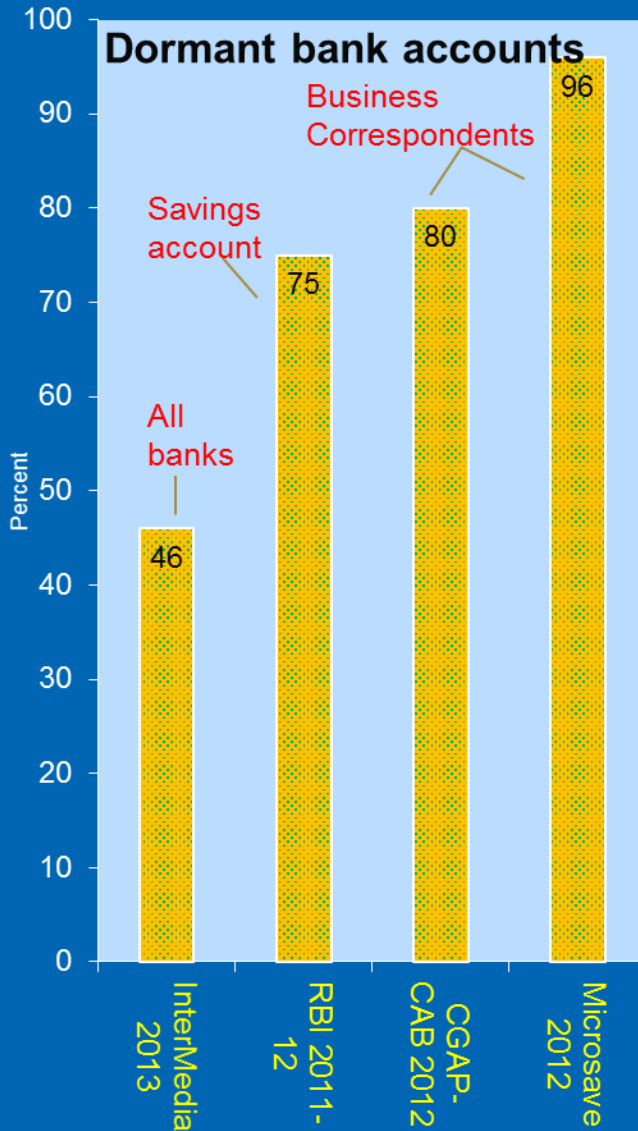


Source: All India Debt and Investment Survey

3. The Supply Side: Policy and Infrastructure

- Efforts to make financial services more inclusive have been taking place over the last forty years
- Fundamental policy shift that began in 1969 with the nationalization of fourteen privately held banks. Between 1968 and 1990
 - Priority sector lending and lending to the small-scale sectors increased significantly increased from 2.5% to 31%
 - Bank branches in rural areas increasing from 18% to 60%
- Policy shift in 1990s: Emphasis on improving the efficiency and profitability of the financial sector
 - Share of credit to the agriculture and small-scale industry declined to 19% by 2005
 - Over 5000 rural branches were closed down
- In 2006, with the twin objectives of ensuring both greater financial inclusion and outreach of the banking sector the RBI introduced the Business Correspondents (BCs) model

The Business Correspondents (BCs) Model



- **BCs** are retail agents engaged by banks for providing banking services at locations other than a bank branch or an ATM
- In March 2014, over 3,30,000 BCs were operating in rural areas covering close to 40 per cent of the villages, and 60,000 were operating in urban areas
- CGAP-CAB 2012 survey
 - An astonishing 80 per cent of zero bank balance accounts were lying dormant
 - 47 per cent of the banking correspondents they attempted to contact were untraceable
- While the BC model does increase reach, it does not necessarily translate into use.

4. The Demand Side: Factors Determining the Use of Financial Services

Households face many barriers which impede use of financial services even if they have access

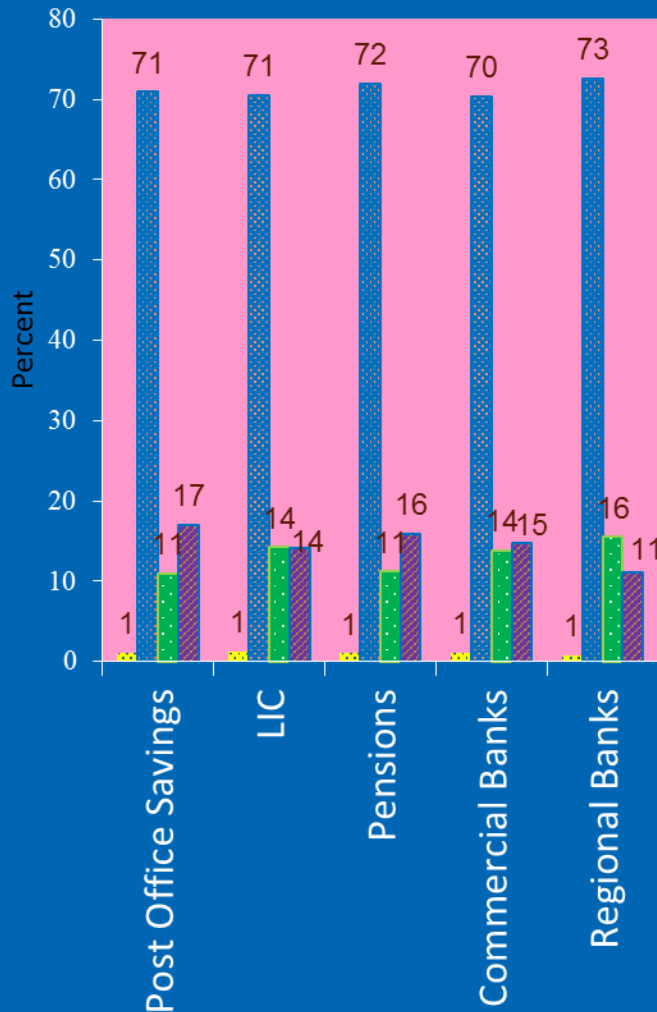
- Households may lack the financial capability to save and invest
- They may not trust the banking service model available to them
- They may lack knowledge of the available financial instruments
- They may be risk averse
- The distance to the nearest service centre may be a deterrence.

Financial Capacity to Save and Invest

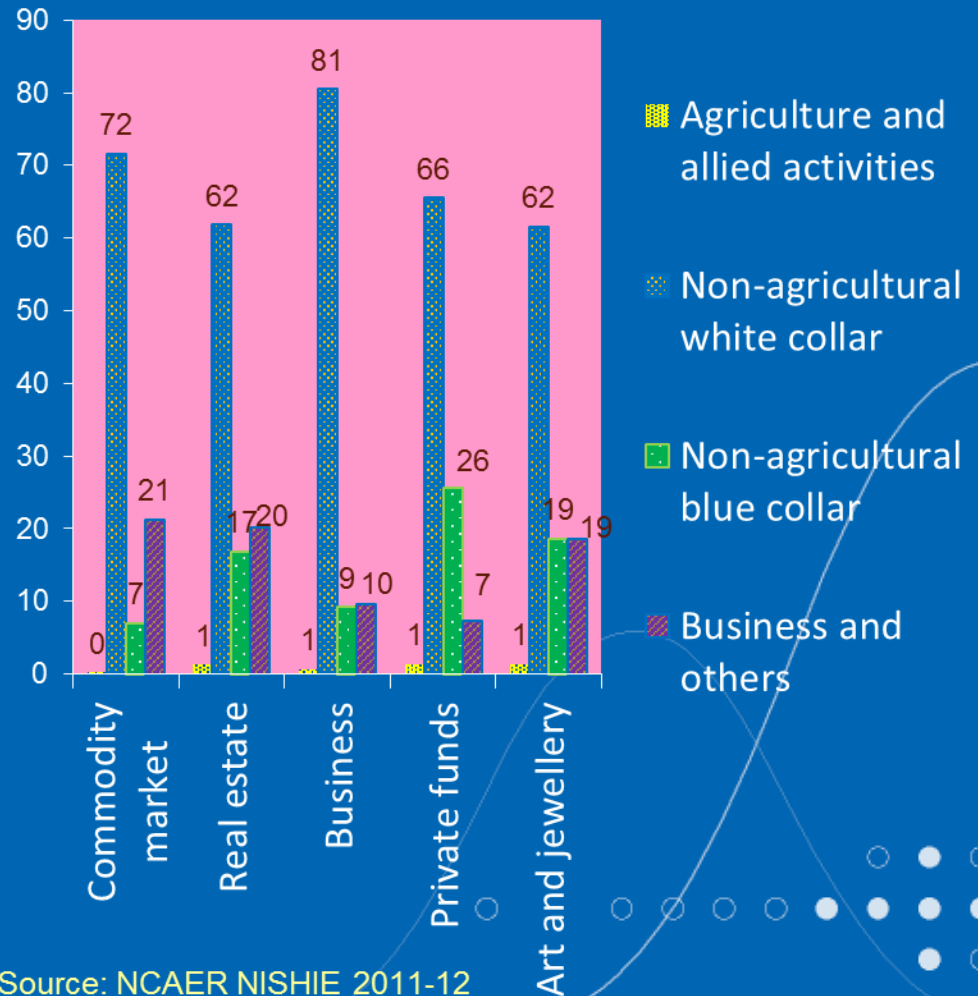
- As per the NCAER- NSHIE 2011–12 survey and the InterMedia FII 2013 Tracker Survey, the majority of the households do not participate in the financial markets
- Of those who save, the poorer and more disadvantaged group of agricultural and allied activities households form just 1% of the savings in the formal market
 - They do not save in other options too (real estate, commodity markets etc)
- The bulk of their credit needs are met by moneylenders

Savings Profile

Profile of saver households by saving options



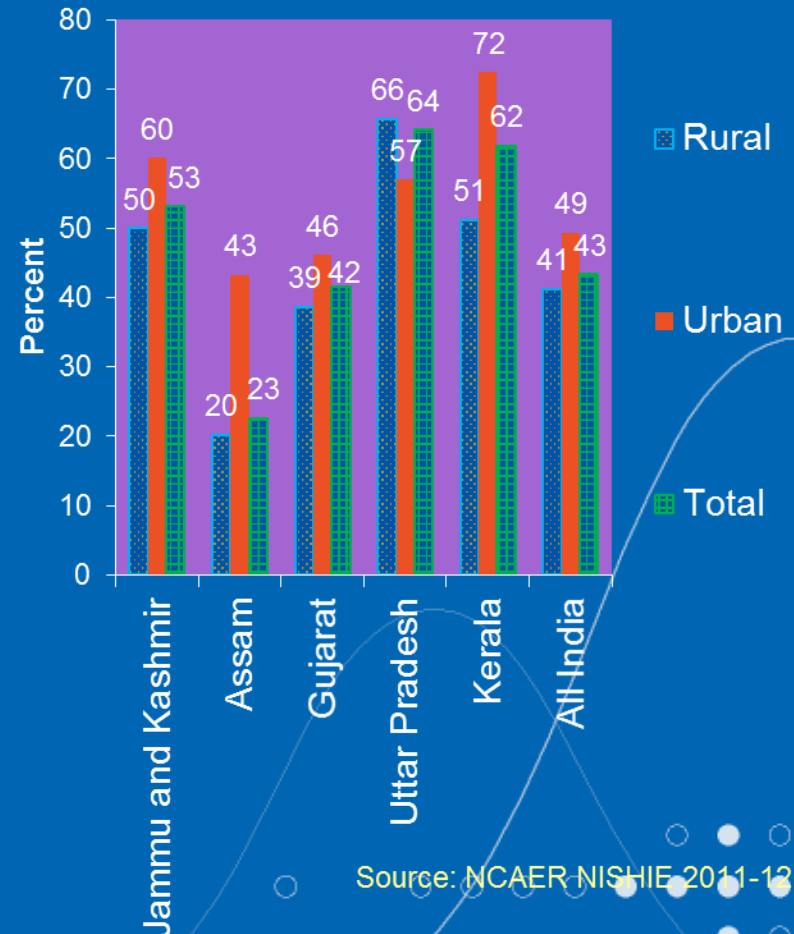
Profile of non-saver households by other options



How do the Casual Wage Labor Fare?

- The casual wage labour comprise 38 per cent of all households at the All-India level, while at the state level it varies widely
 - In Assam, casual wage labour comprise 13 % of the households of which only 1/4th have bank accounts
 - In Uttar Pradesh, casual wage labour account for 1/3 of household with almost 2/3 of them having bank accounts
- However, all the surveys have documented that the casual wage labour lean more towards informal sources of finance in times of economic hardships
- Hence, to differentiate between access and usage becomes even more important . Just chasing and satisfying numeric targets will have no real impact on making the lives of the poor better

Percent of casual wage labor who have a bank account



Building Trust

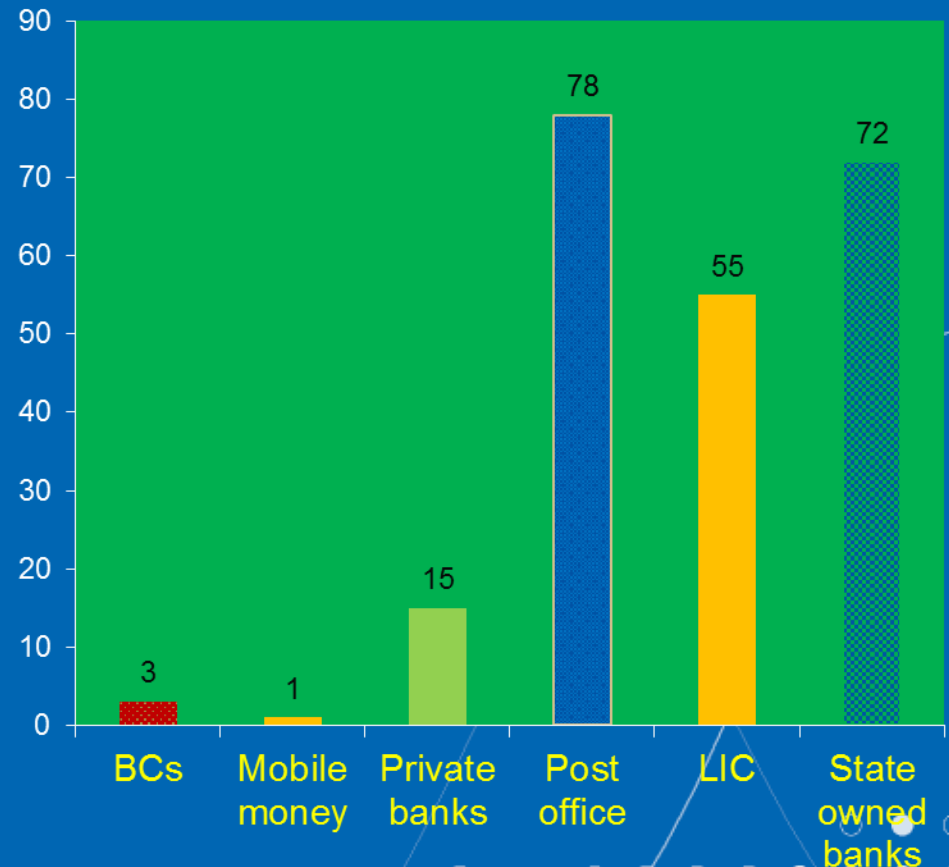
- At the all-India level, the predominant sources of savings and investment by households are
 - Savings accounts in banks (33 per cent), investment in gold (24 per cent), insurance (13 per cent) and cash at home (11 per cent)
- Factors like the rate of returns, simplicity, flexibility, liquidity and tax benefits were not major factors in decision making
- What matters?
 - TRUST



BCs and Mobile Money Fall Short

- The InterMedia India FII Tracker Survey (2013), only three per cent of household fully trust BCs with their financial transactions
- Couple this fact that over 47 per cent of the BCs are not traceable after they open an account
- Just the two factors of lack of trust and absence alone will probably explain why 80 to 96 per cent of accounts opened by BCs lie dormant

Percentage of households who "fully trust" financial services



Source: InterMedia India FII Tracker Survey 2013-14

Other demand side factors

- Risk aversion
 - Over 53% of households fall in least risk-taking category
 - The degree of risk-taking behavior increases with education and income and decreases if living in rural areas and are married
- Distance: Inverse relationship between having a bank account and the distance to the bank
- Religion: The greatest variance in religion and bank access is in the second quintile
 - 37% of those practicing Christianity have a bank account while 52% of those practicing Sikhism have a bank account.

5. What can we learn and what are the challenges

- The government has made significant strides in improving access to financial services. In 2011 almost 60 per cent of households in India had access to credit
- However
 - A large percentage of bank accounts lie dormant
 - With the growing commercialisation and modernisation of Indian agriculture, the credit needs in the rural areas is now far greater than before. Without formal access to credit, the rural moneylenders, now posing as suppliers of inputs and consumer goods, for-profit non-banking finance companies (NBFCs), middlemen and buyers of produce, and owners of the land, still continue to have a firm hold on rural credit
- The BC model has often been called the “rock star” of financial sector reforms. As far as targets go, there is no doubt that this model has performed very well. Main issue is the lack of trust of the depositor in the BC.

Challenges and Way Forward (1)

- Institutions: BCs work on very low profit margins and low commissions, so ways to incentivize BCs and improve their profitability will have to form part of a holistic financial inclusion strategy
- Supply side of credit can be improved with more specific and innovative instruments
 - Banks could create venture capital funds on a small scale to finance first time entrepreneurs. Would reduce risk and the need for them to look for informal sources of finance at high interest rates
 - The government could also consider providing greater infrastructure and extension support for enhanced credit flow to agriculture
 - Other innovative products to promote savings and use of financial services could include an “index based insurance” where payouts are based on a measurable index like rainfall, commodity price etc

Challenges and Way Forward (2)

- From the demand for financial services, the behaviour becomes more complex
 - Small and marginal farmers and casual wage labour, who form bulk of the workforce, do not save and invest and lean toward informal sources of credit in times of financial hardship.
 - For this class of the poor, a more comprehensive risk management and poverty alleviation program together with a push towards greater financial literacy and access to financial services is essential
- Other factors too play an important role . These include the adequacy, timeliness, affordability and convenience of financial services, the literacy levels of household, their income levels, the risk preferences, religion, distance to a bank and geography
- Hence, more needs to be done than the mere chasing of numerical targets so that “financial inclusion” becomes more practical and more meaningful for poor and the disadvantaged in the long run.

Thank you

