INDICUS FOUNDATION

POLICY BRIEF
October 2016

MAKING FINANCIAL INCLUSION WORK FOR THE POOR

Key Takeaways

This policy brief takes up the role of financial service providers in raising adoption levels amongst the poor and highlights the need for better data to guide policy and financial services providers. Policy makers and industry have typically seen financial exclusion as a problem affecting rural areas, while the crux of the problem lies in the income characteristics of the household. Keeping the target segments of financial inclusion in mind, this policy brief brings data-based analyses of the financial lives of the poor in India and highlights the need for customer centric products and processes. The main takeaways from the brief are as follows:

1. A regular national survey is essential to track granular data on usage and unmet financial needs of the population by geography and income segment.
2. The business case for financial inclusion will come through for financial services providers when they adopt a customer centric approach to products and processes. Banks must now address the psychological distance that the poor face in their banking experience.
3. Strong customer protection and grievance redressal mechanisms are imperatives to build trust in formal financial services.

Background

India's financial inclusion mission aims at delivery of financial services at an affordable cost to the vast sections of disadvantaged and low-income groups, the segment that the Reserve Bank of India refers to as "hitherto excluded sections of society"(RBI, Annual Report 2015-16).While the2016 Brookings Financial and Digital Inclusion Project Report gives India a 100% score on country commitment and 94% on regulatory environment, adoption of selected traditional and digital financial services scores a low 44%. Table1 gives the scores for each indicator for adoption; while penetration of accounts has the maximum score, all other indicators of usage are rated low. Clearly, now, the focus of all stakeholders must be on raising usage of financial services.

According to the vision set out by the Reserve Bank of India Committee on Medium Term Path to Financial Inclusion, over 90 per cent of the hitherto under served sections of society would become active stakeholders in economic progress by 2021, and this will be achieved through empowerment by formal finance. At the present juncture, access to financial services has improved significantly; it is time to ensure that the financial inclusion mission truly serves the poor. The RBI continues to stress that there is a strong business case in catering to the under served segments of the society, with digital technology now giving a significant boost. For the business case to come through, more detailed data is needed on the financial lives of the poor.

Understanding the Target Segment: the low income customer

Despite rising income levels and economic growth, India's population of 1.25 billion, and growing, is largely formed of low income consumers. According to the Financial Inclusion Insights Survey (Intermedia, 2016), three quarters of India's population live on less than USD 2.50 a day; a quarter of India's population lives in extreme poverty on less than USD 1.25 per day. While the RBI's Financial Inclusion Plans and the Pradhan Mantri Jan Dhan Yojana have ensured access to financial services in rural areas, adoption of these services remains a challenge.

It is well known that the financial lives of the poor have certain fundamental characteristics that do not match conventional banking

Table 1 : Indicators for Adoption of Traditional and Digital Financial Services - India 2016

Indicators	Score out of a maximum of 3
Formal financial institution account penetration among lower-income adults	3/3
Formal financial institution account penetration among women	2/3
Borrowing from a financial institution	1/3
Saving at a financial institution	2/3
Debit card use	1/3
Credit card use	1/3
Percentage of adults utilizing online bill payments and purchases	1/3

Source: 2016 Brooking FIDP Report Detailed methodology available at https://www.brookings.edu/wp-content/uploads/2016/07/fdip_20160803_project_report.pdf

Table 2 : Characteristics of India's Income Segments

Indicators	Living on more than $2.50 a day	Living on between $1.25 and $2.50 a day	Living on less than $1.25 a day
Share of total population	22%	52%	26%
Urban	59%	31%	13%
Rural	41%	69%	87%
Literate	89%	68%	43%
Numerate	99%	96%	91%
Own a mobile phone	81%	60%	40%
Owns a bank account	75%	64%	51%
Own an NBFI account	10%	10%	7%

Source: Financial Inclusion Insights Survey, Intermedia 2016

models: incomes and transactions are irregular and of low value; the poor have few assets, and typically lack records for the assets they do possess; the bulk of credit requirements are for what banks would typically consider as non-productive consumption purposes; the underprivileged are also time constrained and cannot easily take time out during peak working hours. **Policy makers and industry have typically seen financial exclusion as a problem affecting rural areas, however, the crux of the problem lies in the income characteristics of the household.** While this segment is more likely to be found in rural areas, with urbanization and migration, the Intermedia survey shows that around a third of Indians living between USD 1.25 and USD 2.50 a day are urban residents. The challenge of providing access to services will differ across rural and urban locations, but when it comes to usage of financial services, policy and industry responses should focus on financial behaviour across income segments.

Each income segment would have different financial needs and Mr S. S. Mundra, Deputy Governor, RBI distinguished between three different segments (19th September 2016) to define the banking approach. For the first group of people who generate adequate surpluses, the objective would be to sensitise them about different avenues of investment, including the capital market. Products like recurring deposits, SIPs etc. would be preferred for the second group of people who generate meagre surpluses. For the third group, people who have recently been introduced to the financial system, who live on subsistence income and do not generate any meaningful surpluses, the goal would be to encourage usage of basic savings accounts, electronic transactions, government pension and insurance schemes etc.

Understanding the various segments therefore allows for tailoring the products and processes appropriately. This policy brief uses data from the Financial Inclusion Insights Survey (Intermedia, 2016)since official estimates on usage of financial services across income segments are lacking in India. **Here the government or the RBI could institute regular national surveys on financial services access and usage, that will throw more light at the granular level across geographies and income segments.**

The advantage of using digital technology to provide financial services to low income customers has been well accepted, but the Intermedia Survey shows that whether it is literacy or owning a mobile phone, the numbers look progressively worse as income levels drop. Consequently, a product like the Unified Payments Interface, launched recently by the NPCI, is poised to be a game changer for digital payments, but will have limited utility for low-income customers. From the policy angle, therefore it is more crucial to focus on channels like the USSD to promote digital financial transactions amongst low income customers. On the positive side, numeracy is high even amongst those living in extreme poverty, and ownership of bank accounts has crossed the halfway mark in this segment.

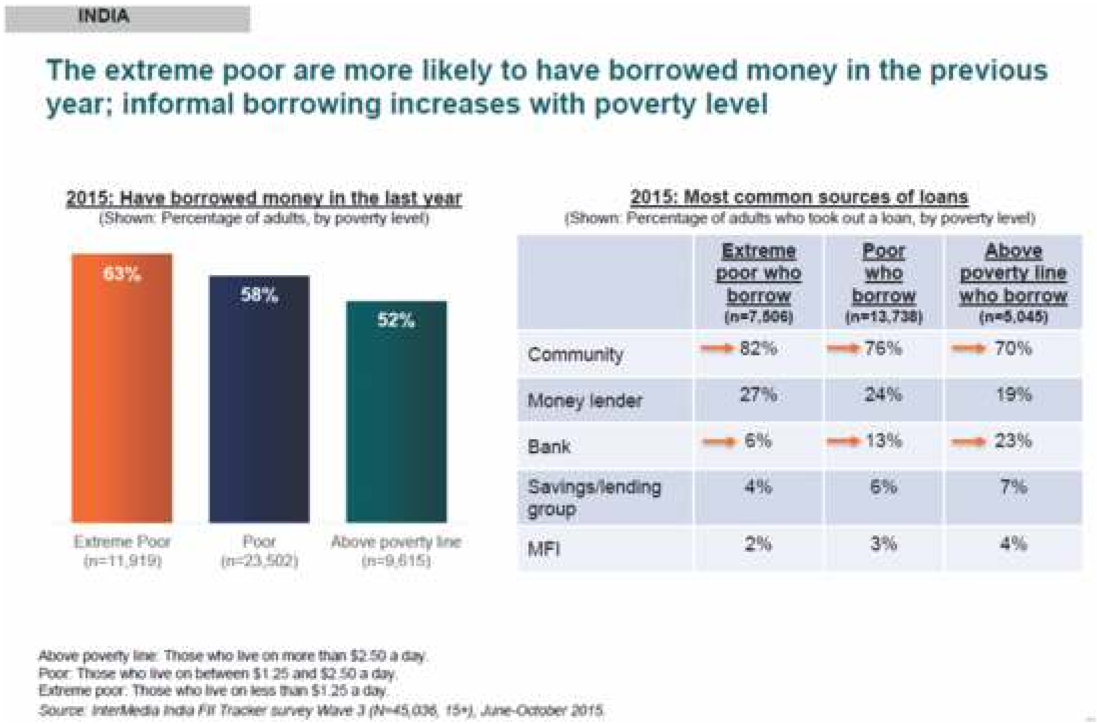
Tailoring credit products for low income customers

Financial inclusion policy since the 1950s has focused on enhancing credit to the disadvantaged sections, essentially through mandates on priority sector lending. Despite these mandates, the credit needs of the poor continue to remain unmet. By defining the targets through sectors, e.g agriculture, MSME etc. rather than income of the household, there is little focus on those at the bottom of the pyramid and their needs. The Intermedia survey shows that while the Pradhan Mantri Jan Dhan Yojana has played a stellar role in raising bank account ownership, for credit needs, people continue to turn to their family and friends, the community they belong and the village moneylender. As Figure 1 shows, those at the bottom of the pyramid are not only more likely to borrow, they rely on informal networks more heavily.

The data show that the poor are comfortable with cash, and deal in networks they trust. These networks are not easy to replace – without credit history and assets, these customers remain out of the comfort zone for banks. A survey of PMJDY account holders and Bank Mitras (Improving Engagement with PMJDY Accounts, Final Mile, August 2016) used behaviourial science insights and revealed that the high degree of uncertainty in their lives make the poor depend on their informal channels more. The emphasis on paperwork and associated officialdom in banks keeps the poor away. Yet, banks have now begun making the loan process more comfortable for the poor and are using available digital data to assess a customer's credit score. M Shwari is a stellar example of innovative digital credit from Kenya (See How M-Shwari Works: The Story So Far - CGAP, April 2015).

In India, the Suvidhaa-Axis Bank partnership is a good example. Suvidhaa, a payments and Business Correspondent firm, tied up with Axis Bank to use its remittance transactions data as a substitute for low-cost credit appraisal for its existing customers (An Indian Start for Digital Credit, CGAP, August 2, 2016). The strengths of the partners have been leveraged optimally – Suvidhaa is responsible for the agent network, remittance transaction data and customer management while Axis Bank takes the capital risk and shares operational overheads. While offering cost-

Figure 1 : Characteristics of Borrowing by Income Segment
(Financial Inclusion Insights Survey, Intermedia 2016



effective, affordable credit to low income customers, with no credit history or assets, the process is seamless with disbursal of loan within 24 hours of the application.

Adapting learnings from global experiences to specific geographies and income segments in India and leveraging unique strengths of partners can bring a revolution in providing credit to low income customers in India. Going forward, CGAP lists six common errors for providers to avoid when deploying digital credit schemes (An Introductory Course to Digital Credit, CGAP, July 2016):

1. Offering credit without a strong remote identification system. When you can't verify customer identity, offering remote services is difficult, especially at scale.
2. Poor targeting, where credit offerings attracted a high-risk applicant pool.
3. Cumbersome loan application processes that meant few people came forward to apply.
4. Credit scoring models that were too conservative and did not allow credit to be extended to more than a small fraction of applicants.
5. Poor product design, such as a transfer fee for moving money to/from a mobile money account that quickly made the product unviable.
6. An excessive focus on credit scoring but the absence of a sound collections strategy.

Tailoring savings products for low income customers

The Intermedia survey dispels the notion that the poor do not save - data show that the percentage of people saving is, in fact, the same across all three income segments, around 87-88%. What differs is the manner in which people save, and the amount. While, as expected, the well-off are more likely to save in a bank account, 47% of those living in extreme poverty are saving in a bank account. This insight from the data is encouraging, as it corroborates the growing coverage of banking services under the PMJDY.

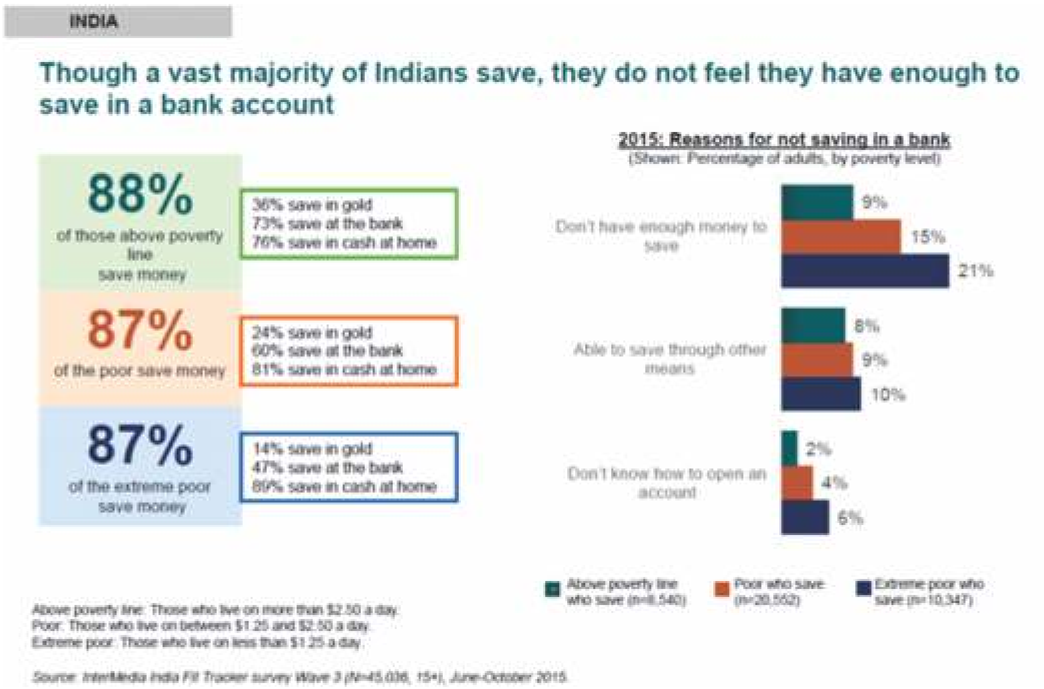
The Final Mile study of PMJDY account holders revealed a distinction between the segment's low ability to create savings, and their strong intent to save. A strong "present bias" and a seeming lack of self control led to a tendency to spend on discretionary items, with the decision often based on "whether account holders can afford to borrow for it, rather than whether they have enough money to pay for it". Given the choice of saving money in a bank account that allowed withdrawals at any time and a bank account that allowed withdrawal only at the time of a festival in after nine months, people overwhelmingly chose the more constrained option.

However, it is not just the features of the product, but also the process of savings that must be made simpler, seamless and transparent. The Final Mile study highlighted the high psychological distance that people felt towards banks - often the poor are overwhelmed when interacting with bank officials, there are class, caste and language barriers that intimidate the poor in a bank setting. Further, the language and terminology used by banking staff form another challenge. Branch staff and Bank Mitras need to be sensitised with soft-skills training to ease the banking experience for the poor. For digital products, financial service providers should ensure easy to follow menus, minimal steps to complete transactions, and use language that is vernacular, colloquial and intuitive.

The Road Ahead

Even as the government and the RBI have their specific responsibilities in building an enabling infrastructure and landscape for inclusion, customer centricity in products and processes is key to raising adoption of financial services by the poor. CGAP brings out this point in its report, Customer Experience Toolkit, September 2016, "A large proportion of financial

Figure 2 : Characteristics of Savings Behaviour across Income Segments (Financial Inclusion Insights Survey, Intermedia 2016)



service provider customers do not use their accounts (68 percent of mobile money accounts, for example, lie dormant). At the same time, two billion people around the world remain excluded from the formal financial sector. CGAP believes that a lack of customer focus by financial service providers is a primary cause of these disparities. Financial service providers now have a great opportunity to create value by designing and delivering positive customer experience – based on a granular understanding of needs, which in turn creates value as customers choose and use their products and services. "Such granular understanding calls for detailed data; the role of the government/RBI is vital here to institute **a regular national survey that will track data on usage and unmet financial needs of the population by geography and income segment.** The data generated will give a more holistic picture of progress under the financial inclusion mission and can help financial service providers design products and processes that meet the needs of the poor.

To create this customer centricity in products and processes, there are three lessons for financial services providers that emerge from the Final Mile study on PMJDY account holders and Bank Mitras (Does financial inclusion really include? Pawan Bakhshi and Anand Parameswaran, Hindu Business Line, May 31, 2016):

1. **Design products that bridge the gap between current and future needs:** Banks should create relevant products that include constraints on withdrawal and focus on particular needs like education and marriage giving the poor a goalpost to bank and save. Rather than leave the government subsidy payouts in zero balance accounts, automated transfers to a savings account or pension account can raise savings. Banks could design communication to inform people that they can borrow small values against monthly inflows. Further, given the familiarity of customers with loan repayments it might help to bundle small savings into loan repayment plans.

2. **Address the psychological distance:** Banks also need to address the psychological distance that low income customer face in addition to the physical distance. Branch staff and Bank Mitras need to be given sensitised through soft-skills training to engage with low-income customers and help reduce their inhibitions and intimidation of accessing a bank.

3. **Recalibrate financial literacy initiatives:** The focus of financial literacy initiatives from banks must move to 'process literacy'; in other words, explain "how" to save or borrow rather than "why".

Finally, given that the formal financial system is aiming to replace informal networks that the poor are already comfortable with, **strong customer protection and grievance redressal mechanisms are imperatives to build trust in the new system** (See Digital Financial Inclusion - Addressing Customer Concerns - ICFI Policy Brief October,2015).Thus, financial service providers should follow the guidelines set by the Reserve Bank of India's Charter of Customer Rights regarding grievance redressal and sensitise agents. Government advertisements through various media channels can help raise customer awareness of their rights, and put pressure on providers for compliance. The financial services industry should work with the government to build an appropriate framework for customer consent architecture. Financial service providers should build systems to lead consumers through clear explanations of the terms of usage, including informed consent.

To conclude, without appropriate customer centricity built into the system, the challenge of financial inclusion will remain, even as data on aggregate number of accounts and agents may show it as resolved on government records.