MicroSave India Focus Note 95

Saddling Up a Dead Horse: Financial Inclusion in India

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May 2012

Background

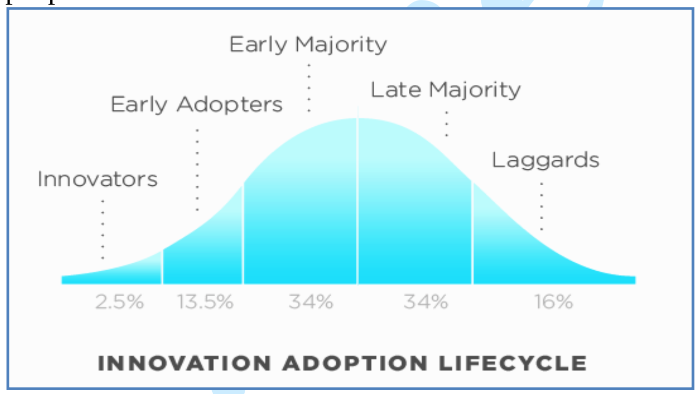
The no-frills accounts (NFA) focussed approach to financial inclusion has so far been largely ineffectual. Several studies have shown that NFAs are rarely active as demonstrated by three independent studies – carried out by Centre for Microfinance, Skoch Development Foundation and *MicroSave*, [1]which estimate that around 80%-90% of the no-frills accounts are inactive. A remarkable fact is that these three studies conducted at different points in time in different geographic locations have come up with surprisingly close estimates of inactivity; indicating that dormancy is a common phenomenon and that not much has been achieved in terms of true financial inclusion over the years.

The Customer's Perspective

There is little that clients can do under the current mode of financial inclusion other than basic liquidity management – a complex formal sector substitute for money kept "under the mattress". While a transaction mechanism for daily cash management is indeed a core requirement for low income customers, the low activity levels indicate that no-frills accounts – even when delivered through business correspondents (BCs) - are hardly used even for this basic need. The customers still seem to prefer keeping money under the mattress - perhaps because of its simplicity and convenience.

This fact seems to question a basic premise of financial inclusion: that there is a need, even if latent, for formal sector financial services among low income households. What providers often forget, in their zeal to achieve the financial inclusion targets set by RBI, is that there is often a product adoption process. The service (i.e. a facility to conduct banking or financial transactions using BCs) fundamentally changes the clients' understanding and experience of financial services. As far as clients are concerned, not everyone is keen to try out something new; especially when there are alternatives they can and do use – even if these are informal and risky.[2]

Everett Rogers, in his seminal work, *"Diffusion of Innovations"*, points out that not all customers approach innovations in a similar manner. The figure below depicts the approach to innovations by different categories of people.



Rogers argues that any innovation will be initially adopted by the first two categories – innovators and early adopters, who will act as opinion leaders to influence other categories of customers.

Does the Current Financial Inclusion Strategy Meet the Needs of Early Adopters?

In India's approach to financial inclusion, providers forget the innovators and early adopters. The innovators and early adopters (normally the village elite who are more familiar with formal sector financial services in general) are overlooked in the frenzied race to open accounts for the poorest inhabitants of the villages - allotted to banks under their financial inclusion mandates. At the Business Correspondent Network Managers (BCNMs) Forum facilitated by *MicroSave*, this was raised as one of the core issues.[3]

The exclusion of potential innovators and early adopters in the BC driven financial inclusion arises for the following reasons:

- No frills accounts, which are often the only product offered on a BC channel, inherently have features (transaction limits, no chequebooks, no debit cards etc.) that make them unsuitable for more affluent customers.

[1] Platt, Ann-Byrd et.al, "No Thrills – Dormancy in NFA Accounts", *MicroSave*, May 2011; Thyagarajan S, Jayaram Venkatesan, "Cost –Benefit and Usage Behaviour Analysis of No Frills Accounts: A Study Report on Cuddalore District", College of Agricultural Banking and IFMR Centre for Micro Finance, December 2008; "Speeding Financial Inclusion", Skoch Development Foundation, July 2009

[2] Agrawal et al. "Savings Perceptions and Preferences in India The Relative Risk to the Savings of the Poor Summary Overview"

[3] See *MicroSave* India Focus Note 90 "Taking Financial Inclusion to the Next Level", March 2012

- Accounts opened at the BC often cannot be operated using other banking channels.
- Many banks expressly prohibit an ordinary saving account holder from opening a no frills saving account. Since no-frills accounts are often the only service available over the BC platform, this provision denies the BC service to most of their current customers (who are likely to act as early adopters).
- The focus of financial inclusion is often on *"excluded"* villages, where current customers of the bank are absent or have limited presence.

The exclusion of potential early adopters from the "financial inclusion" initiatives deprives service providers of an important mechanism that could help drive adoption and usage.

The Supplier's Perspective

The overwhelming feedback we, at *MicroSave* have received (usually off the record!) from senior bankers is that there is no compelling business proposition to promote financial inclusion. Financial inclusion is viewed as a regulatory compulsion, and/or as a social initiative. As a result, it is common to see massive account opening and BC appointment drives with minimal focus on implementing an effective and functional transaction mechanism.

At the bank branch level, the problem is compounded with staff often viewing no-frills accounts as an increase in workload with no real benefits in terms of improved business. This attitude manifests itself in the form of a hostile environment for BCs and low income customers, and in the lack of operational support provided to BCs.

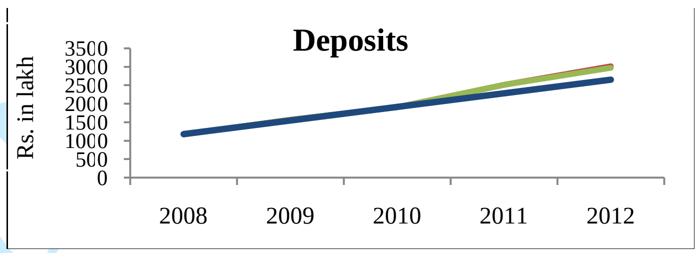
There is also a prevalent belief among bankers at all levels – from the senior managers to the branch staff – that the business correspondent model is a *poor man's service*. They often actively discourage walk-in customers (provided they are relatively well to do) from availing services at the BC.These factors turn the lack of belief in the business case into a self fulfilling prophesy, as evidenced by the paltry levels of activity in most BC initiatives.

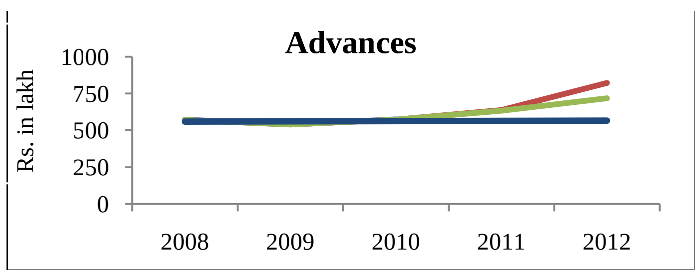
What is Needed?

What is really needed is a change of perspective. Providers need to think of the BC model as a "distributed banking model" rather than as a "financial inclusion drive" to meet regulatory compulsions or social objectives. The distributed banking model includes within it the possibility to increase bank's business substantially across diverse products and services. The entire retail banking product suite (subject to regulatory restrictions or strategic considerations) needs to be made available over the BC platform. This needs to be seamlessly integrated with the core banking system of the bank to ensure that current customers can act as early adopters and opinion leaders who drive adoption in their villages and to enable customers to use the financial products and services that they require.

A Demonstration of the Value Added to the Provider by a Distributed Banking Model

In a branch of a nationalised bank[4] in India, where all credit and savings products were being delivered through the BCs, there was not just an increase in business due to what was directly brought in by the BCs, but even an increase in regular walk-in business. The graphs below display this phenomenon clearly. This is perhaps due to decongestion of bank branches as BCs help to ease the transaction pressure and improve efficiency.





The blue line is a trend line of the branch business based on past business. The red line is the actual business while the green line is the walk in business (business not brought in by BCs).

Conclusion

There is definitely a need for product and channel innovations to suit specific needs of low income customers. But the priority is to make the channel accessible to all so as to facilitate sustainability and gradual adoption. The early signs are that there is indeed value in pursuing a *"distributed banking"* strategy as opposed to a *"financial inclusion"* strategy. Financial inclusion will naturally follow the establishment of an efficient, distributed banking channel.

[4] Name withheld due to non-disclosure mandates