

# Fintech and Inclusion

## 1 Introduction

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India is the fifth-largest economy in the world<sup>1</sup> with a GDP of over 2.66 Trillion USD (INR 135.6 lakh Crores<sup>23</sup>). However, despite the economic growth during the past two decades, the informal economy in India still accounts for more than 80 percent of non-agricultural employment. Further, as per an ILO note, “Informality also has a gender bias. Women are somewhat more likely to be engaged in the informal economy but significantly more likely than men to be working as informal workers in the formal sector”<sup>4</sup>.

The implication of this extremely large informal and unorganized sector is that a significantly large proportion of the Indian population is either self-employed or is dependent on small enterprises. To unlock the full potential of this segment access to finance becomes critical. The absence of a continued supply of working capital, underinvestment in enterprises, and lack of basic risk insurance has multiple consequences. It leads to low and erratic productivity resulting in lower risk-taking ability of entrepreneurs, which in-turn makes it harder for such enterprises to grow and scale.

Improving access to financial services through inclusion has always been an important aspect of State policy. Starting from the nationalization of banks to programs such as IRDP to targeted lending requirements and branch licensing policies to differentiated licenses offered by RBI, each of these initiatives has evolved, but the need for inclusion has always remained important and has continued to be behind the need.

It will be wrong to say that we have not made rapid strides in improving access to financial services. One of the big achievements has been universal access to a bank account. The Jan Dhan Scheme of the government sought to offer a bank account that could offer or send money on a real-time basis to anyone. What has been even more impressive has been the ability for users to be able to make use of this bank account. Aadhaar Enabled Payment System (AEPS) has made it extremely easy for users to make transactions without filling out forms, the need to sign or remember pins. Transactions can be authenticated by the use of a biometric finger print making payment systems easily accessible.

However, many low-income and informal sector users do not use their bank accounts other than for very limited involuntary transactions such as receiving loans in the bank accounts or receiving subsidies in their bank accounts. The percentage of the population aged 15+ with a Financial Institution account has increased to c80% from c53% in 2014, however, c48% of accounts remained inactive<sup>5</sup>. There continues to be a significant mistrust of the banking system, not related to the safety of the money, but largely due to excessive costs, opaque processes, no sense of timelines or predictability of outcome.

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<sup>1</sup> <https://data.worldbank.org/>

<sup>2</sup> [india gdp: India Ratings pegs FY22 GDP growth at 8.6% on data revision, Auto News, ET Auto \(indiatimes.com\)](#)

<sup>3</sup> The amounts between USD and INR don't tally when multiplied with exchange rates largely due to estimation methodology differences

<sup>4</sup> [Informal economy in South Asia \(ILO in India\)](#)

<sup>5</sup> Source: <https://globalfindex.worldbank.org/sites/globalfindex/files/countrybook/India.pdf>, <https://globalfindex.worldbank.org/>

The introduction of UPI saw a significant increase in the usage of digital cash. While cash usage remains high, in most cities, including tier 3 and tier 4 cities, most hawkers, auto drivers, and shopkeepers have embraced QR-based digital transactions. The value of UPI-based transactions has increased from 0.57 billion in 2017 to 71.56 billion in 2021<sup>6</sup>. NPCI reported that about a third of Indian households are using UPIs – while 1 in 2 in the richest 20% households use digital payments, while 1 in 4 households in the poorest 40% use it<sup>7</sup>. At the launch of Account Aggregator, an important piece of financial infrastructure, that allows customers to aggregate their financial and potentially non-financial data for seeking better financial services, Dr Nandan Nilekeni suggested that the country has nearly 120 million unique customers that have made at least a single transaction using UPI. While this number compared to the potential 850 million customers looks small, the growth of users has been exciting. To our mind, it isn't obvious that the number of users will increase on their own very quickly. Specific steps will need to be taken to bring everyone in the fold of digital payments.

Less than 3 percent of adults have ever made a capital market transaction. The number of Demat accounts have increased to 7.4cr in October 2021, more than double of 3.6cr in March 2019, but still forms a small percentage of the population<sup>8</sup>.

The use of informal savings has continued to remain high. The go-to savings products for most low-income households and informal sector households continue to be gold and chit funds.

Similarly on the credit side, barring simplistic low-value loans such as group loans, most customers do not have access to any good credit products such as working capital finance, business loans, affordable housing finance. Loans available are extremely expensive, largely on account of transaction costs and not necessarily expected loss rates. 200 million unique individuals are credit-active in India, credit products penetration in the rural segment is only 8%<sup>9</sup>.

Most households don't have any decent insurance coverage available to them. Health-related expenditure remains one of the most common reasons for households to slip back into poverty. Only 28.7% of households have at least one member covered by a health scheme or insurance<sup>10</sup>

## 2 Fintech Vision 2030

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Our vision for 2030 is not just a wish list. It provides a framework for what transforms finance into a human capacity just like health and education to become a fundamental human capacity. Most of the 17 goals<sup>11</sup> as enlisted under the Sustainable Development Goals seem to depend on the availability of financial services.

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<sup>6</sup> <https://www.npci.org.in/what-we-do/upi/product-statistics>

<sup>7</sup> <https://www.pymnts.com/digital-payments/2021/india-upi-platform-logs-record-100b-in-transactions/>

<sup>8</sup> <https://pib.gov.in/PressReleaselframePage.aspx?PRID=1780999>

<sup>9</sup> [https://www.business-standard.com/article/finance/half-of-india-s-working-population-of-400-mn-people-credit-active-report-121062900822\\_1.html](https://www.business-standard.com/article/finance/half-of-india-s-working-population-of-400-mn-people-credit-active-report-121062900822_1.html)

<sup>10</sup> <http://rchiips.org/nfhs/pdf/NFHS4/India.pdf>

<sup>11</sup> [Sustainable Development Goals | United Nations Development Programme \(undp.org\)](#)

## **2.1 Ubiquitous Financial services**

Simply speaking, financial services need to be easily accessible to each individual in terms of geographical proximity. While geographical proximity is important, it may not be sufficient. Morduch and Rutherford (2003) identified, in the context of microfinance, that dimensions of reliability of access, it being available on a continuous basis, access being convenient and flexibility as important<sup>12</sup>. These dimensions hold true not only for microfinance but all financial services. The following are additional parts of our vision for ubiquity

1. Each adult member in each household has access to a smartphone with a working data connection
2. More than one *cash-in-cash-out* point available to each household within a distance of 0.5 km
3. Each customer has access to their credit score and their ability to understand their access to credit available through an app. It is also important to have a transparent system that helps the customer understand the reasons, if any, that make it hard for them to access credit.

## **2.2 Data based design**

When it comes to financial services, more is not always good. More credit could be detrimental and more than adequate insurance could be expensive and can eat into the surplus of the household. To our mind, in the next 10 years, the following will be the key elements

1. Each household has access to data-based personalized advice and a personalized suite of financial services, offered with minimal fine print and in language that is best understood by the customer.
2. Each individual has access to their data and has full control over their ability to share their data for the creation of personalized financial solutions. Similarly, each customer also has the right to have access to their data removed in a seamless fashion.

## **2.3 Access to multiple financial services**

Financial products are imperfect substitutes to each other. For instance, while it is not uncommon for customers to finance health related expenses through sale of investments or by taking a new loan, however, this is extremely expensive for the customer. It is not incorrect to say that the distance between a middle-class household to poverty is a single medical bill. Our vision for access to financial services therefore is for all households to have access to multiple financial services and includes the following

1. Each household has access to an honest bank account that has no charges levied to a customer without explicit customer consent.
2. Each household has an emergency line of at least INR 10,000 (2 months expenses) available to them preferably through savings but in an extreme situation available through a liquidity line that can be drawn at a notice of 1-2 hours.
3. Each household has some life insurance available to them (even if it does not meet all their requirements). This needs to be purchased voluntarily.
4. Each household has tertiary health care available to them, either under state scheme, central scheme or under voluntary critical and catastrophic covers.

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<sup>12</sup> Morduch, Jonathan and Stuart Rutherford (2003); "Microfinance: analytical issues for India", Essay for the World Bank, South Asia Region — Finance and Private Sector Development, April 2003.

## 2.4 Digital payment access

Unless cash usage is reduced, access to financial services will continue to be an artificial plant on consumers. Our vision for digital payments will include the following

1. Each household is able to make digital payments (with assistance) to make payments from their bank account and is making at least one transaction a month for Bill payments
2. Each household is making at least 1 P2P payment a month and is making nearly all utility payments online

## 2.5 Access to high-quality service

*Caveat emptor* is often used in the context of the responsibility of customers to choose wisely. However, the information asymmetry in financial services makes it very hard for this to be a fair ask. Vision for high-quality service for financial services includes

1. *Do no harm* is embedded in every service provider's solution. A provider is responsible for solutions offered.
2. Financial services Portability: Customers are often locked in with their service providers either because of some benefit attached or on account of friction to switch. For instance, users often would struggle to shift from a poor bank account to a better serviced account, because of the challenges in making a change to all mandates that have been set up on the account. Customers may have monthly direct debits of loan EMLs, Savings SIPs and Monthly bills, etc on a particular bank account. Resetting such mandates is extremely taxing. We envision a world where a customer can carry their bank account along with its number to any other bank therefore reserving all such mandates. Some insurance policies are already portable (benefit of policy vintage that allows the customer to be covered for pre-existing illness cover). Making it mandatory for all financial services to be portable just like the mobile number portability will improve customer service across the board.
3. One of the big roadblocks for households to access finance in a reliable and convenient manner comes from the parts where digital services meet physical on ground processes. The hurdle becomes insurmountable when it comes to records of movable and immovable property that is often offered as security. To unlock finance, it would greatly help if all assets of a household are digitized, including property records that allow for a quick verification of title and valuation that can allow simpler and faster access to credit for all individuals and enterprises.

## 3 Need for Advocacy

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Indian Financial system prides itself on stability, unfortunately sometimes this stability comes at the cost of experimentation. We have three strong regulators in RBI, SEBI, and IRDA for a very small proportion of the population participating in financial services. Products such as investments are offered by entities regulated by each of these regulators and have very different regulations, cost structures, permitted margins and distribution margin. KYC requirements for even basic accounts being used by low income users are amongst the most stringent in the world even in terms of purchasing power parity. An ideal regulatory framework would offer the following

1. Possibility for experimentation

2. Easier and digital KYC
3. Portability of KYC. In case the customer uses a full KYC bank account or Wallet for any other financial service such as a purchase of an investment or insurance policy in their own name, there needs to be no need for any further KYC.
4. Open banking norms to enable solutions without the need for license
5. Ability of banks to rely on third parties for core functions – no change in responsibility
6. Financial products portability
7. Automatic seeding of bank account with mobile numbers
8. PAN and Aadhaar numbers to be used interchangeably now that PAN and Aadhaar linkage deadline is close to being met.

#### **4 Need for government intervention – Public goods/ Infrastructure**

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Financial services will need some support in the form of public funding. Private markets will always be plagued by the imperfect alignment between shareholder value and the customer well-being. At the same time, price caps and targeted services as an instrument to tackle this failure, can sometimes distort unit economics for the provider, that in turn leads to product designs that don't work well for the customers for whom such price caps were intended.

We note, for instance, that several banks at the time of opening bank accounts for low-income households, get customers to opt out of taking a debit card. The debit card allows merchant transactions and set up a UPI handle. The reason why a debit card is typically not issued comes from negative perceived unit economics which comes from an RBI directive to offer 4-5 free ATM transactions per month. Withdrawals by a customer from a different bank's ATM leads to significant costs.

We believe that public funding to the user of the services in the form of a DBT to access digital financial service to offset the cost charged by providers starts to create positive unit economics for private providers. In most cases, the amounts were not large but such small funding could be catalytic. Increased used creates volumes which in turn eventually also obviates the need for such public funding.

We recommend the following as key areas for public funding.

1. Reimbursement of MDRs for certain customer categories. This has already been done for certain transaction values and we recommend that this continues.
2. Reimbursement of cash-in / cash-out charges for low-income households via DBT credits.
3. Income tax refund of 1% - 2% of the total tax payable by the household for all payments made to low-income households such as domestic help, drivers, hawkers, etc via bank accounts (subject to say a max of INR 5000 of tax refund per annum) to facilitate more incomes going to low-income households via bank accounts
4. Fraud insurance for customers