The Hearth Lecture Series

Trendspotting: Why Things Matter

Session: 21st November 2023

Diversifying Paths to Financial Inclusion: Rethinking Finance for All

There is mounting evidence that financial inclusion has a multiplier effect in economic growth and poverty alleviation. The United Nations Secretary General's Special Advocate for Inclusive Finance for Development refer to 'financial inclusion' as an enabler and accelerator of economic resilience and growth. The goal of financial inclusion is more than mere access and envisages responsive and responsible financial services for users. This focus on quality seeks sensitivity towards customer needs, capacities, and safety. In keeping with the global acknowledgement of financial inclusion as a key driver to sustainable development, there have been policy and regulatory initiatives in India. For instance, the Reserve Bank of India (RBI) released a National Strategy for Financial Inclusion 2019-2024 in 2020 in recognition of demand in India for differentiated banking to cater to various niche segments and emphasis has been placed on 'Access', 'Usage' and 'Quality' in measuring financial inclusion.

Diversifying Paths to Financial Inclusion: Rethinking Finance for All unravels these pathways towards economic empowerment emerging in India in response to policy initiatives and market response. Rather than focus on a single point of intervention, the discussion will explore the intricate mechanisms that must harmonise to foster stable, sustainable, and inclusive financial models for economic empowerment and greater financial literacy. The audience is invited to consider the implications of accepting alternative mechanisms for improving financial access, the cause and effect of market failures underlying the mainstream financial models, and their consequences on long-term industry policies, practices, and theories.

Excerpts from Recommended Readings

1. National Strategy for Financial Inclusion (NSFI): 2019-2024

The National Strategy for Financial Inclusion 2019-2024 by the Reserve Bank of India (RBI) released in 2020 notes that the bank-led model of financial inclusion adopted by the RBI through issuance of differentiated banking licenses (small finance banks and payments banks) and the launch of Indian Post Payments Bank in September 2018 has helped bridge the gap in last mile connectivity. However, certain critical gaps remain an impediment for financial inclusion, such as: (i) inadequate infrastructure (in parts of rural hinterland, far flung areas in Himalayan and north-eastern region), (ii) poor tele and internet connectivity in rural hinterland, (iii) socio-cultural barriers, and (iv) lack of market players in payment product space. RBI identifies six strategic objectives of a national strategy for financial inclusion: (i) universal access to financial services, (ii) providing basic bouquet of financial services, (iii) access to livelihood and skill development, (iv) financial literacy and education, (v) customer protection and grievance redressal, and (vi) effective coordination. To achieve this vision, it identifies certain milestones such as: (a) providing banking access to every village (or hamlet of 500 households in hilly areas) within a five km radius by March 2020, (b) strengthening digital financial services to create infrastructure to move towards a cash less society by March 2022, and (c) ensuring that every adult has access to a financial service provider through a mobile device by March 2024. For providing universal access to financial services, RBI notes that while schemes such as PMJDY have created the required banking infrastructure to enable financial inclusion, efforts are required to improve access to insurance and pension services. It recommended that every willing and eligible adult who is enrolled under PMJDY should be enrolled under an insurance or pension scheme by March 2020. Similarly, for financial literacy and education, specific modules for target audience (children, entrepreneurs, senior citizens) should be developed through the National Centre for Financial Inclusion and centres for financial literacy should be expanded to reach every block in the country by March 2024. NSFI accessible here. Excerpt is from PRS Report summary accessible here.

2. **Purva Khera, Chapter 7: Digital Financial Services and Inclusion in India's Financial System: Building the Foundation for Strong and Sustainable Growth, 2023, International Monetary Fund**

This chapter looks at India's growth in financial inclusion over the last decade, identifying key drivers and economic impact, focusing on digital financial services as a tool for expanding financial inclusion. Facilitated by unique digital infrastructure and enabling regulatory environment, digitalisation is helping close India's financial inclusion gap. It is also improving targeting of government support to households, as witnessed during COVID-19. The expansion of digital payments is also an important driver of economic development and has helped stabilise incomes in rural areas and boost sales for firms in the informal sector. Using data prior to the pandemic shows that wider adoption of digital payments could increase India's GDP per capita by 3 to 4 percentage points. Even though the country has made immense progress in widening accessibility for the majority of the excluded population, including through a strong supply-side push for digital financial services, policies should focus more on addressing demand-side constraints to promote use of financial services, which remains low. Improving financial and digital literacy, internet, and smartphone access, and expanding digital government payments to households (government to person) will help close the emerging digital divide. At the same time, strengthening consumer protection, data privacy, and cybersecurity remain crucial to promoting safe financial inclusion. Chapter available here. Access the book here.

3. **Nandini Jayakumar, Rajnish Kumar Chandra, Brijesh P., & Prayag Singh Rawat, RBI Bulletin, 2023, Housing Finance Companies and the COVID-19 Pandemic: Does Size Matter?**

Housing Finance Companies (HFCs) play an important role as the second largest lender in the housing finance space and one of the largest borrowers of the financial system. The HFC sector weathered multiple challenges in the last few years, with the COVID-19 pandemic striking the most recent blow. Authors examine the heterogeneous impact of the pandemic by studying the relationship between credit growth of HFCs and their size and find that vis-á-vis big HFCs, credit disbursements by smaller HFCs declined in the post-COVID period. In India, HFCs are an important financing channel to the housing and real estate sector and are instrumental in providing affordable finance to marginalised and new-to-credit borrowers. The sector exhibits oligopolistic characteristics, with the largest five HFCs accounting for around 85 per cent of the total assets at end-September 2022. In this regard, recent scale-based regulation introduced by the Reserve Bank seeks to regulate these bigger entities more stringently. The COVID-19 pandemic struck a blow to the HFC sector, which was already reeling under difficulties. Nevertheless, as the economy began inching toward normalcy on the back of liquidity support from the government and regulatory forbearance, the sector also showed signs of revival. Balance sheet of HFC sector recovered and continues to remain sound in terms of asset quality and profitability. The impact of the pandemic, however, differed for bigger and smaller HFCs. We establish this heterogeneity by using quarterly data and find that vis-á-vis big HFCs, credit disbursements by smaller HFCs declined in the post-COVID period. Our results remain robust to various controls and validity checks. In the wake of existing demand-supply gap in the housing sector, HFCs, as the second largest player in the housing finance space, are instrumental in providing accessible and affordable finance options to desiring borrowers. Apart from larger HFCs that dominate the sector, many small players also operate in this space and have developed geographical expertise and knowledge of local markets. They play an important role in promoting last-mile financial inclusion by providing access to housing finance to customers in tier-II and tier-III geographies and their strengthening will reinforce the 'Housing for all' agenda. Read here.

4. **Asian Development Bank, Case Study, 2022, In India, Financial Literacy Programs Are Lifting Families Out of Debt and Fuelling New Prosperity.**

In 2014 the government launched Pradhan Mantri Jan-Dhan Yojana, a programme aimed at providing a bank account for every household. The programme generated a record 443 million accounts for India's households since its August 2014 launch through to early January 2022. However, closing the banking gap also requires at least a basic understanding of how the financial system works. Only 27% of Indian adults – and 24% of women – meet the minimum level of financial literacy as defined by the Reserve Bank of India. Women are particularly responsive to financial literacy outreach. Traditionally they manage the household budget and are often eager to start home-based businesses. When armed with foundational knowledge, financial literacy tools, and small-scale business opportunities, women entrepreneurs can make a remarkable impact on their families and communities.

5. **The Global Findex Database 2021, The World Bank**

In developing economies, the share of adults making or receiving digital payments grew from 35 percent in 2014 to 57 percent in 2021. In high-income economies, the share of adults making or receiving digital payments is nearly universal (95 percent). Receiving a payment directly into an account is a gateway to using other financial services. Indeed, 83 percent of adults in developing economies who received a digital payment also made a digital payment, up from 66 percent in 2014 and 70 percent in 2017. Almost two-thirds of digital payment recipients also used their account to store money for cash management; about 40 percent used their account for saving; and 40 percent of payment recipients borrowed formally. Database accessible here. Data on India here.

6. **Yan Carrière-Swallow, Vikram Haksar, & Manasa Patnam, International Monetary Fund, 2021, Stacking Up Financial Inclusion Gains in India.**

The India Stack is widening access to financial services in an economy where retail transactions are heavily cash based. A digital ID card dramatically lowers the cost of confirming people's identities. Open-access software standards facilitate digital payments between banks, fintech firms, and digital wallets. And access to people's personal data is controlled through consent. The expansion of digital payments, facilitated by the stack, is an important driver of economic development in India and has helped stabilise incomes in rural areas and boost sales for firms in the informal sector (Patnam and Yao 2020). Other emerging market and developing economies could learn from the experience. Read here.

7. **Jon Frost, Leonardo Gambacorta, Hyun Song Shin, International Monetary Fund, 2021, From Financial Innovation to Inclusion**

Digital technology is transforming the financial industry, changing the way payments, savings, borrowing, and investment services are provided and who provides them. Fintech and Big Tech companies now compete with banks and other incumbents across a range of markets. Meanwhile, digital currencies promise to transform the heart of finance: money itself. But just how much has technology advanced financial inclusion? For sure, in the past year alone, digital finance has helped households and businesses meet the challenges posed by the COVID-19 pandemic. It has also given governments new ways of reaching those who need support. Progress to date has been impressive. Yet if it is to realise its full potential in bolstering financial inclusion, private sector innovation must be supported by the appropriate public goods, as innovation has large spill overs to all aspects of economic activity. Public goods provide the underpinnings of financial inclusion. Read here.

8. **United Nations, Better Than Cash Alliance, et al, 2018, Igniting SDG Progress Through Digital Financial Inclusion**

More people than ever have access to mobile phones, the internet, and other digital services like prepaid cards, with the number growing every day. How can this digital revolution help us reach the 2030 Sustainable Development Goals more quickly? One important answer is through digital financial inclusion. Financial inclusion means affordable, effective, and safe financial services for everyone. Inclusive digital financial services refer to mobile money, online accounts, electronic payments, insurance and credit, combinations of them and newer fintech apps, that reach people who were formerly excluded. Digital financial inclusion, when provided responsibly and sustainably in a well-regulated environment, not only drives growth, but also enables faster progress toward many of the other SDGs, as this compendium shows. Inclusive digital financial services mean that poor people can store and increase savings, cope with unexpected economic shocks, access social benefits more cheaply, and make investments in economic opportunities that can lead them out of poverty. For example, the widespread use of digital financial services in Kenya helped lift around 1 million people out of extreme poverty between 2008 and 2014 (SDG 1). Farmers are managing risks and making investments that result in higher yields and incomes (SDG 2). Women are gaining more control over their finances and greater economic opportunity (SDG 5). Businesses are accessing working capital to grow and create new jobs (SDG 8 and SDG 9). The compendium contains 13 SDG briefs on how digital financial inclusion can ignite progress. Available here.

9. **Abdul Latif Jameel Poverty Action Lab (J-PAL). 2018. "Reducing the cost of lending to low-income borrowers." J-PAL Policy Insights.**

A review of nine randomised evaluations evaluating credit scoring systems, dynamic incentives, and the use of social pressure finds these efforts to reduce costs can improve efficiency and accuracy of bank processes, encourage repayment, and reduce default. These innovations are effective because they generate information that changes decisions of lenders, borrowers, or both. Technology, particularly in the form of digital credit, holds great potential to substantially reduce the costs of providing credit, but impact evaluations are ongoing. Read here.

10. **Banerjee, Abhijit, Esther Duflo, Rachel Glennerster and Cynthia Kinnan. 2015. "The Miracle of Microfinance? Evidence from a Randomized Evaluation." American Economic Journal: Applied Economics, 7 (1): 22-53.**

This paper reports results from the randomised evaluation of a group-lending microcredit programme in Hyderabad, India. A lender worked in 52 randomly selected neighbourhoods, leading to an 8.4 percentage point increase in take-up of microcredit. Small business investment and profits of pre-existing businesses increased, but consumption did not significantly increase. Durable goods expenditure increased, while "temptation goods" expenditure declined. We found no significant changes in health, education, or women 's empowerment. Microcredit plays its role as a financial product in an environment where access to both credit and saving opportunities is limited. It expands households' abilities to make different intertemporal choices, including business investment. The only mistake that the microcredit enthusiasts may have made is to overestimate the potential of businesses for the poor, both as a source of revenue and as a means of empowerment for their female owners. Available here.

11. **Center for Financial Inclusion at Accion & The Institute of International Finance, 2017, Joint Report, How Financial Institutions and Fintechs Are Partnering for Inclusion: Lessons from the Frontlines.**

This report examines how partnerships between mainstream financial institutions (e.g., banks, insurers, and payment companies) and fintechs are addressing financial inclusion challenges and expanding access to the formal financial economy for underserved segments of the global population, particularly in emerging markets. It incorporates insights from 24 in-depth interviews with people at the frontlines of this innovation and highlights 14 partnerships focused on financial inclusion that exemplify best-case scenarios and good practice. Contrary to the popular narrative, financial institutions view fintechs as partners in innovation, not threats to their core business. By offering better, less expensive, and more innovative products, financial institutions can assert their continued relevance as customer-facing institutions with help from fintech partnerships. Read full report here.