Conference Edition

Effect of Consumer Finance on Financial Inclusion in India

Saon Ray
Smita Miglani
Sandeep Paul

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Authors

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Overview

One of the most discussed issues of modern times, financial inclusion or access to financial services, is a major development goal for all nations across the globe. A multidimensional concept, financial inclusion can be thought of as the proportion of individuals and firms that use financial services in an economy (World Bank, 2014). The level of financial inclusion varies across the world, with the share of adults in developed countries holding an account at a formal financial institution, more than twice the share in developing countries (World Bank, 2014). While access is certainly the pillar of financial inclusion, use of financial services is also important. While access essentially refers to supply of services, use is determined by demand as well as supply (Demirgüç-Kunt, et al., 2008).

The Case of India

Ensuring quality access to formal financial services in a country of 1.3 billion people has always been a challenge for the Indian government. Despite having been a priority on the policy agenda for decades, the goal of universal financial inclusion is yet to be achieved. While much of the problem is due to lack of access and financial literacy, there is also evidence for voluntary exclusion in India. The 2011 census reported that 59% of total Indian households availed banking services, with 67.8% and 54.4% in urban and rural areas respectively. The more recent Global Findex Survey (Demirgüç-Kunt, et al., 2018) reported that in the 15+ age group, 79.9% of the sample population in India had accounts with financial institutions in year 2017. This meant a strong growth compared to 53.1% reported in the previous edition of the survey in 2014, and 35.2% in 2011. One important reason could be the revival of financial inclusion policies in recent times, with the most important initiative being the Pradhan Mantri Jan-Dhan Yojana (PMJDY), launched in 2014. The programme complemented ongoing bank penetration policies and brought a sizable population into the banking fold. While financial inclusion in India was led by commercial banks and Micro Finance Institutions (MFIs), Non Banking Financial Companies (NBFCs) have also been complementing the activities of banks over the past few decades.

The present study looks at the case of the Indian consumer finance sector. Consumer finance involves granting credit to consumers to enable them to possess goods for everyday use. Credit facilities in India can be broadly classified into formal (banks, NBFCs, MFIs) and informal (money lenders, friends, relatives, etc.). While the Indian financial market is changing rapidly, a large number of households still rely on informal sources to finance unforeseen expenses. Considering the size of the unbanked population and the challenge of ensuring quality access to financial services, the case for analyzing the role of NBFCs becomes important.

Any enquiry into the credit market is incomplete without understanding the demand side of the problem. The Committee on Household Finance (RBI, 2017a) notes that trends in financial behavior of households vary across income classes. For example, holding of financial assets is not very popular even among high-income households, and there is clear substitution between real estate and gold as households become richer. It was also observed that higher education is unambiguously associated with a lower share of real estate, and higher shares of both pensions and financial wealth, and thus greater exposure to formal financial markets. The report also looks at the sources of financial vulnerability and how households manage or deal with the risk (using data from the Financial Inclusion Insights Survey). It notes that for the majority of the households (more than 60%), the major financial loss was due to the loss of crops or livestock due to bad weather, medical emergencies involving hospitalization, and damage to properties, farm equipment or other business capital, due to a natural disaster. An enquiry into how households cope with such losses underlines the fact that India is still predominantly an informal economy. While half of the population depends on help from family, friends and moneylenders, only a quarter are able to deal with emergency expenses using accumulated wealth. Formal financial institutions are barely in the picture, implying that the current financial system fails to achieve one of its most important goals that of helping households smoothen cash flows and consumption patterns.

Importance of Consumer Finance for Financial Inclusion

The Indian financial inclusion story so far was led by commercial banks and MFIs. In India, NBFCs have been competing with and complementing the activities of banks over the past few decades. The Financial Stability Report of RBI (2014) notes that, "given the relatively limited reach of the formal financial system, such entities may be playing an important role in supporting the efforts towards financial inclusion." By extending credit to the unbanked, these entities are contributing immensely to financial inclusion. While acknowledging the importance of access to credit for productive purposes, a total integration with financial market also means access to services such as insurance and consumption loans. Financial inclusion is necessary since credit is critical in a country like India where a large percentage of the population is either self-employed or runs small, informal businesses (Rajeev and Vani, 2017).

In India, aided by impressive and consistent growths in national income, private consumption has been expanding. Currently, private final consumption expenditure accounts for about 55% of national GDP and has been growing consistently over the last few years (CSO, 2017). Nevertheless, the finance for these expenses came largely out of savings or informal sources of credit. According to the All India Debt and Investment Survey (AIDIS) of NSSO 70th round, non-institutional agencies account for a significant portion of total loans to Indian households, with a share of 69% in the rural and 58% in the urban areas (NSSO, 2014). It was also noted that most of the debt is incurred for non-business purposes with shares in total debt as high as 81.7% in urban areas, and 60% in rural areas (NSSO, 2014).

The Indian financial market remains primarily informal by nature, from both, the demand and supply sides. Despite gains in financial inclusion, the integration of the majority of people with the market is nil, or far from satisfactory. The gains to be made in this respect are huge, for both, industry and consumers. It has been estimated that if households shift from non-institutional to institutional debt they can move between 2.5 and 5.5 percentage points, respectively, up the wealth distribution ladder (RBI, 2017a). It is in this context that consumer credit becomes important. Most consumer loans are unsecured without any collateral for security to the lending institution and used mostly to finance personal expenses on articles such as vehicles, consumer durables, etc.

The Consumer Finance Sector

Consumer finance refers to activities involved in granting credit to consumers to enable them to possess goods for everyday use. Most borrowing in developing economies occurs through informal sources, family or friends (World Bank, 2014). Retailing, an emerging branch of this sector, looks at extending services not just to cover total financial planning, but also to cover lifestyle planning of customers. A consumer loan is a type of loan given to an individual on a non-secured basis for personal and family expenses, vehicles, homes, etc.

In banks, consumer lending is part of retail credit/ personal credit, a segment that has been gaining much traction in recent times. The share of personal credit[1] in gross credit extended by scheduled commercial banks has been steadily rising over the last few years, too; it currently accounts for more than 24% of gross banking credit in the country with total outstanding loans crossing Rs. 19000 billion, as of March 2018.

Though housing loans and vehicle loans form the biggest chunk of the personal/retail credit sector, other loan products such as consumer durable loans, credit cards, education, individual advances, etc., are also growing impressively. Another rapidly growing sector is that of consumer durables even though their share in total personal loans is miniscule (1.3% of total personal credit). Faced with increasing competition from non-banking finance companies, many scheduled banks are actively promoting this segment. The category of credit card loans is also growing notably, used largely for consumption. A large bulk of credit is in the category, other personal loans, where the purpose of loan is not tied to any particular product of consumption.

While they are much smaller than the banking sector, the NBFCs are also actively trying to expand their consumer-lending business. The growth in NBFC credit to retail segments is evidence of this; the bulk of NBFC credit is apportioned to the industrial sector (about 60% in 2017), but retail credit (16.8% of total credit by NBFCs) was the fastest growing segment in the FY 2016-17.

NBFCs are classified in terms of their liability structures, type of activities and systemic importance (SI). By liability, NBFCs are classified as deposit-taking (NBFC-D) and non-deposit taking (NBFC-ND). By activity, there are 12 categories of NBFCs. At the end of March 2017, 11522 NBFCs were registered with the RBI. There are 239 companies registered with the RBI as NDSI (RBI, 2017b). Of these, 19 provide consumer loans and two-wheeler loans. According to Credit Suisse (2015), the consumer lending market in India is expected to be a US$ 1.2 trillion opportunity for organized lenders by 2020. The market is fast expanding with both scheduled commercial banks and non-banking finance companies aggressively expanding their portfolios. The emergence and rapid spread of finance institutions dedicated to retail finance, such as Tata Capital Financial Services Limited, Bajaj Finserve, HDB Financial Services, etc., has given much visibility of the sector, especially in urban areas.

The retail segment has not only expanded in the last few years but was also the reason for the impressive

[1] The personal loans sector in scheduled commercial banks include loans for consumer durables, housing, advances against fixed deposits, advances to individuals against share, bonds, etc., credit card outstanding, education loans, vehicle loans and other personal loans.

growth rates of credit of NBFCs. Interestingly, within the retail sector it was the consumer durables and credit card receivables which registered impressive growth. While the former grew by 83.9% in 2016-17, the latter grew by 50%. Vehicle/ auto loans, the largest component within the retail sector (41.5%), had in fact, regressed with a decline in actuals. While the reason for decline of vehicle loans is largely attributed to transient impact of demonetization (RBI, 2017c), credit to consumer durables and credit card receivables seems to have largely remained unaffected.

NBFCs have also evolved in terms of their operations, reach and profitability. They may provide end-to-end online personal loans solutions, right from obtaining information, applying for the loan, assistance with eligibility criteria and documentation, approval application and loan disbursal. NBFCs have specialized in different areas: financing commercial vehicles (Shriram Transport Finance), offering loans against gold (Manappuram Finance, Muthoot Finance, etc.), infrastructure financing (Srei infrastructure, IDFC, etc.), or consumer durables (Bajaj Finance, Capital First, etc.). Borrowers prefer NBFCs over banks because decisions are made faster, services provided promptly and there is expertise in niche segments. NBFCs also accept deposits from customers but unlike banks, these are in form of insurance premiums and shares listed on stock markets or held privately. They are not authorized to offer savings bank and other deposit schemes. With a wide geographical reach, product diversity and better understanding of local markets, it is felt that NBFCs can propel India's financial inclusion plans to the next level. Caution with respect to non-uniformity in regulation, pricing of credit and services, and unfair lending practices need to be observed. Self-regulation initiatives in this sector are in the early stages.

Survey Findings

With a view to understanding the perceptions of people towards credits and loans, particularly in the consumer finance segment, a survey was undertaken by ICRIER in March and April, 2018. The survey covered 844 respondents across five cities: Bangalore, Bhopal, Delhi, Kolkata, and Mumbai. The objective was to gauge the importance of consumer finance in financial inclusion. Middle-income and lower-income group respondents (defined as monthly household income of Rs. 25000 and above and monthly household income of Rs. 25000 and below respectively) were included.

Table 1 shows the characteristics of the sample. The survey covered 568 males and 276 females. Hence about one third of the respondents were women. The average income of the sample was Rs. 13443.6. The lowest monthly income was Rs. 1500 (US$ 22.50) while the highest was Rs. 80000 (US$ 1199). It was noted that 179 respondents had no income – of these 67 were students and 100 were homemakers.[2] Figure 1 shows the city-wide distribution of the respondents.

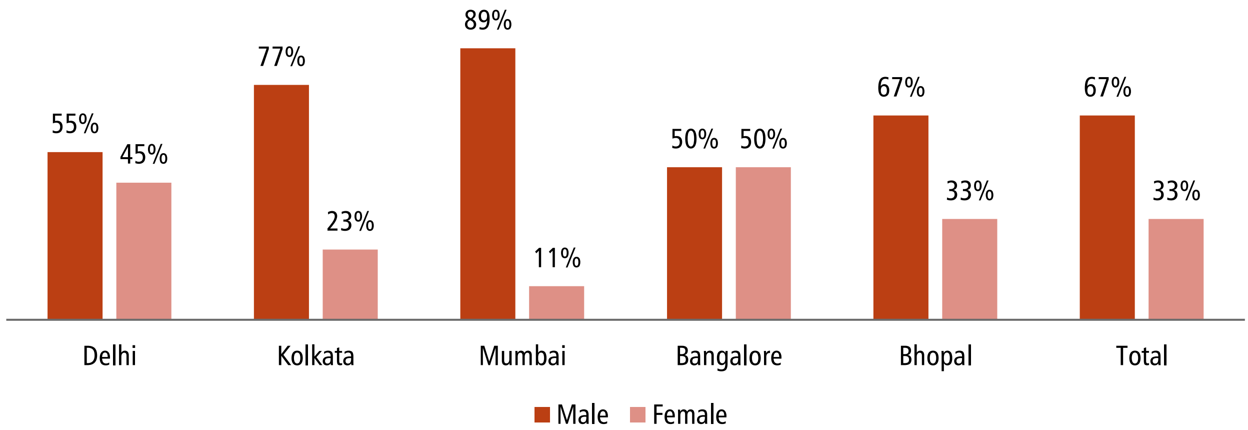
[2] The respondents fell into four categories of monthly family income: < Rs.10000 (18%), 10000-25000 (41%), 25000-50000 (31%), and > 50000 (10%).

Table 1: Sample Characteristics

	Observations	% of Total	Mean	Standard Deviation	Minimum	Maximum
Gender	844		0.327	0.469		
Age (Years)	844		35.150	10.591	18	70
Married (%)	844	72	0.295	0.479		
Secondary education or higher (%)	844	50	3.316	1.391		
Income (Rs.)	844		13443.60	13451.80	0	80000
Own house	844	65	0.706	0.456		

Source: Authors' compilation
Note: the minimum and maximum of binary variables is not reported in the table.

Figure 1: Male and Female Distribution in Five Cities



Source: ICRIER survey

The city-wide distribution of the respondents, along with other characteristics is presented in Table 2. About 65% of the respondents owned a house, and 72% of the respondents were married. Approximately 50% of the respondents had secondary education or higher degrees. The table also reports the number of male and female respondents, the average age of the respondents and the education level of the respondents. This is reported in two ways: first, the number of respondents in each city educated upto high school level and below, and, number of respondents educated to senior secondary (Class 12) level or above. The share of these categories in each city has been shown in Figure 2 which is discussed below. Data on the employment profile of the five cities is also presented in Table 2.

Table 2: Distribution of Respondents Across the Cities

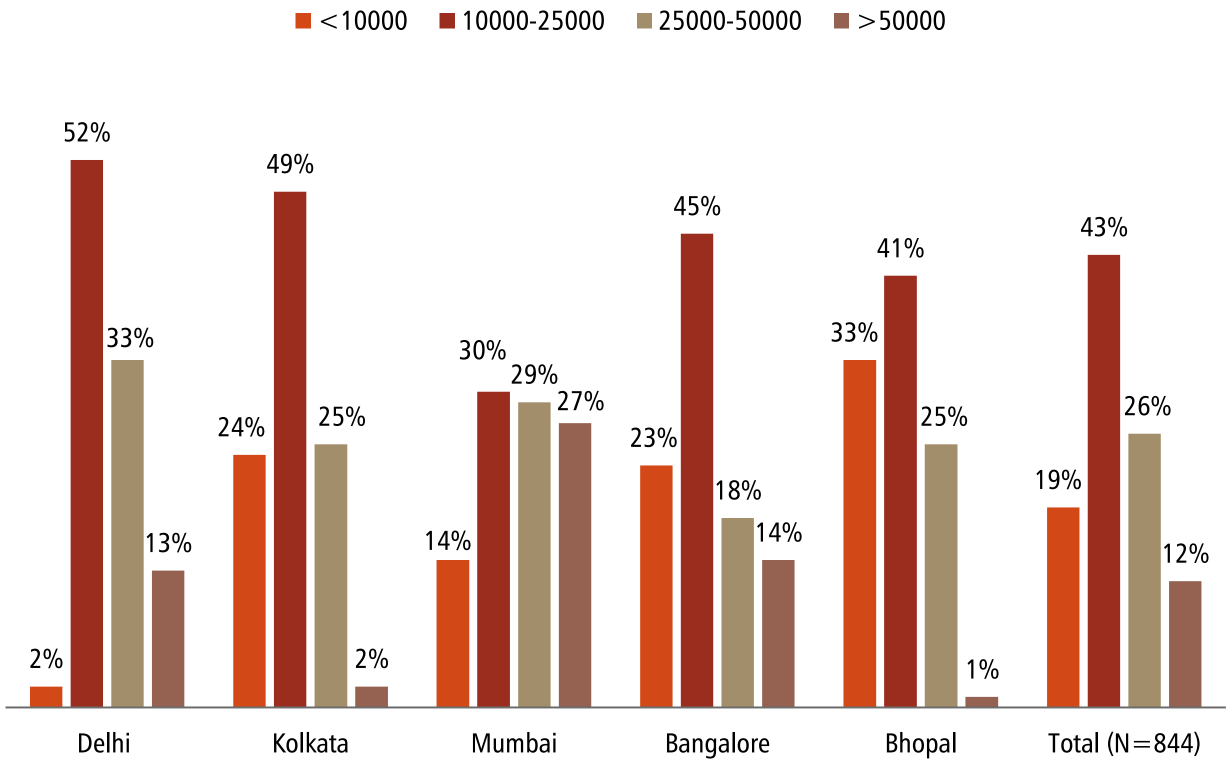
	Bangalore	Bhopal	Delhi	Kolkata	Mumbai	Total Respondents	% of total
No. respondents (male)	94	108	90	132	144		67
No. of respondents (female)	94	52	73	40	17		33
Total number of respondents	188	160	163	172	161		
Average age of respondent	34	33	34	40	35		
Education							
Education level (number of respondents with high school and below)	53	87	95	103	87		50
Education level (number of respondents with senior secondary and above)	135	75	68	69	74		50
Employment							
Employment type - daily wage (% of persons engaged in daily wage by total number of daily wagers)	4	24	39	12	20	123	
Employment type - home maker (% of persons engaged as home maker by total number of home makers)	47	47	47	47	47	106	
Employment type - salaried (% of persons engaged in daily wage by total number of salaried)	54	5	23	17	1	157	
Employment type - self-employed (% of persons engaged in daily wage by total number of self-employed)	16	13	29	17	24	190	
Employment type - students (% of persons engaged in daily wage by total number of students)	8	23	10	29	30	218	
Financial inclusion							
Number of persons with bank account	184	138	153	168	111	754	
Number of persons with loans for consumer durables	132	24	29	61	8	254	
Number of persons with other loans	90	41	31	61	8	231	
Persons without any loans	54	136	134	111	153	588	
Family characteristics							
Type of family – nuclear (%)	92	27	44	82	56		62
Total number of family members (average)	4	5	5	5	4		5

Source: Authors' compilation

About 89% of the respondents had a bank account. Of the 90 persons who did not have an account, 69 were males, while 21 were female. Also, 457 (54%) respondents had bought a consumer durable in the past year. 254 respondents reported having taken a loan to buy a consumer durable in the past year. The source of funds to buy consumer durables, and mobile phones in particular included (only 256 answered this question): banks, 6%; family and friends, 3%; EMIs 36%, while the bulk, 54%, used their own savings. The family income of respondents can be divided into four categories: a) < Rs.10000 b) 10000-25000, c) 25000-50000, and d) > 50000. The percent of respondents in each of these categories were 19, 43, 26 and 11% respectively. Figure 2 below shows the income distribution of the respondents by city.

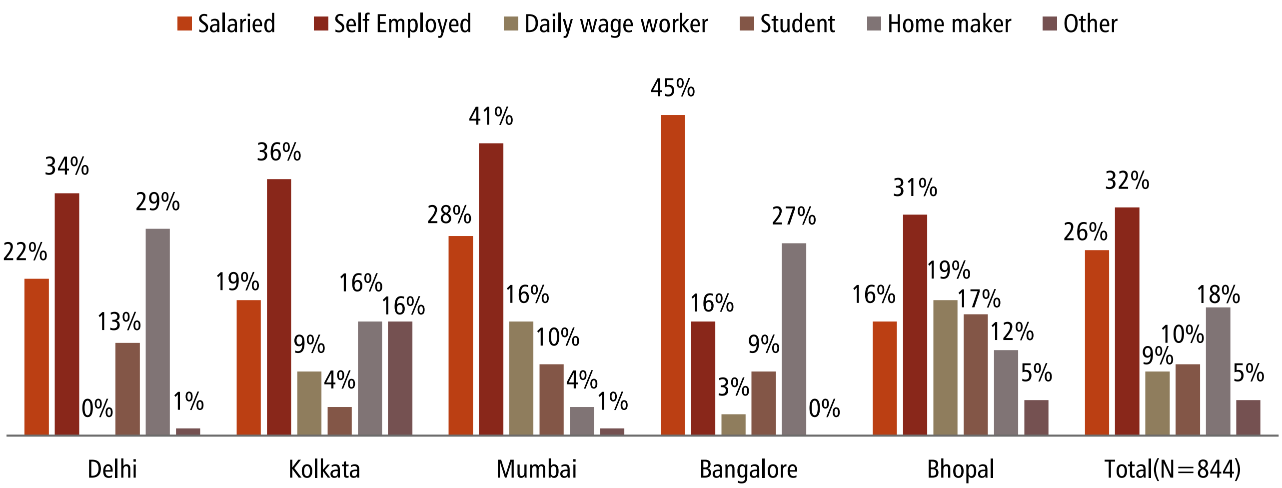
From Figure 3, presented below, we note the employment profile of the respondents in the five cities. There are five main categories: daily wage worker, salaried, home maker, self employed and student. The share of each of the above categories is 15, 13, 19, 23 and 26% respectively. The largest group of respondents in Delhi, Mumbai, Kolkata and Bhopal is self-employed, while the largest group in Bangalore is salaried. The second largest group in two cities,

Figure 2: Income Distribution of Respondents in Five Cities (Rs./month)



Source: ICRIER survey

Figure 3: Employment Profile of Respondents



Source: ICRIER survey

Mumbai and Kolkata, is salaried; in Delhi, the second largest group is in the home maker category, while in Bhopal it is daily wage worker. Some cities also had a sixth category, 'other', which included casual workers, or people who had their own shops, were unemployed or retired persons. The share of this category in overall employment is 6%.

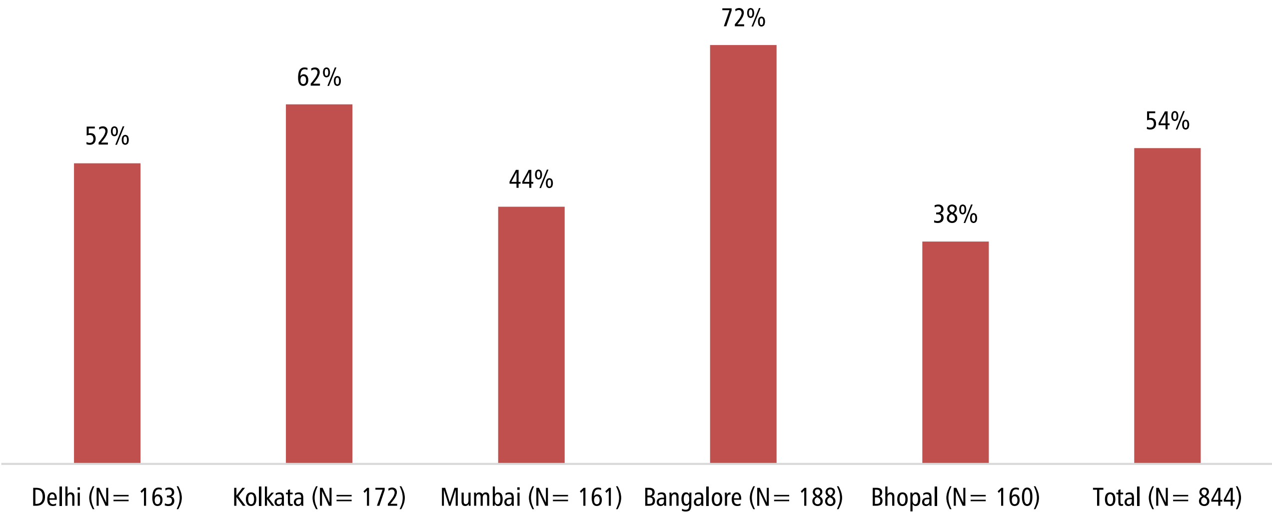
Key Messages from the Survey

The city-wise distribution of data (shown in Figure 4), shows that the highest number of respondents who had bought consumer durables in the last year were from Bangalore (72%) followed by Kolkata (62%) and Delhi (52%). Bhopal reported the lowest, with just about one-third (38%), having made any such purchase.

City-wise analysis of items bought shown in Figure 5 suggests that mobile phone purchase were the highest in Mumbai (78%) followed by Bhopal (68%); kitchen/home appliances purchases were highest in Kolkata (58%) followed by Bangalore (48%); and 2-3 wheeler purchases were highest in Bangalore (23%) followed by Delhi (17%).

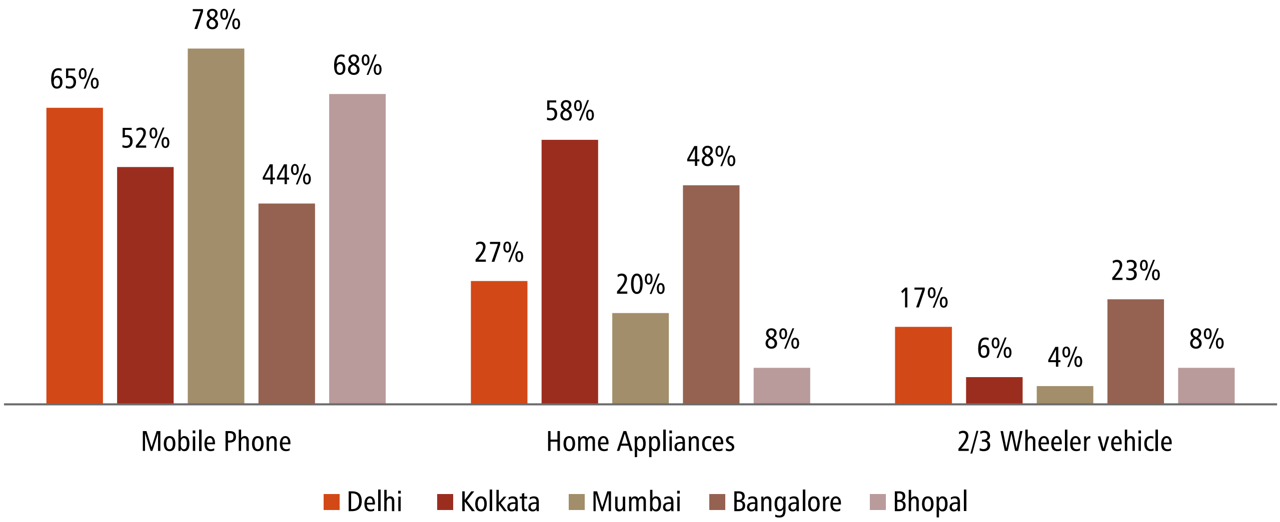
One of the study's key questions was whether the respondents were aware of the availability of loans for consumer products such as mobile phones/ kitchen/ home appliances, laptops or two-wheelers and three-wheelers from NBFCs such as Bajaj Finserve, Capital First, etc. More than half (56%) of the participants responded in the affirmative, of which, 67% were in the middle-income group, while 44% were in the low-income group. At 74%, Bangalore had the highest number of respondents, while only 31% of respondents in Bhopal were aware of the existence of loans through NBFCs. Bangalore also had the highest proportion of respondents who had availed of loans: 70% (belonging to different income slabs) said that they had availed of such loans in different slabs. The quantum of consumer loans taken by the respondents is shown in Figure 6. In Mumbai, 95% of the respondents reported that they had not taken any such loans in the last year.The participant were also

Figure 4: Status of Purchase of Consumer Durables - Cities



Source: ICRIER survey

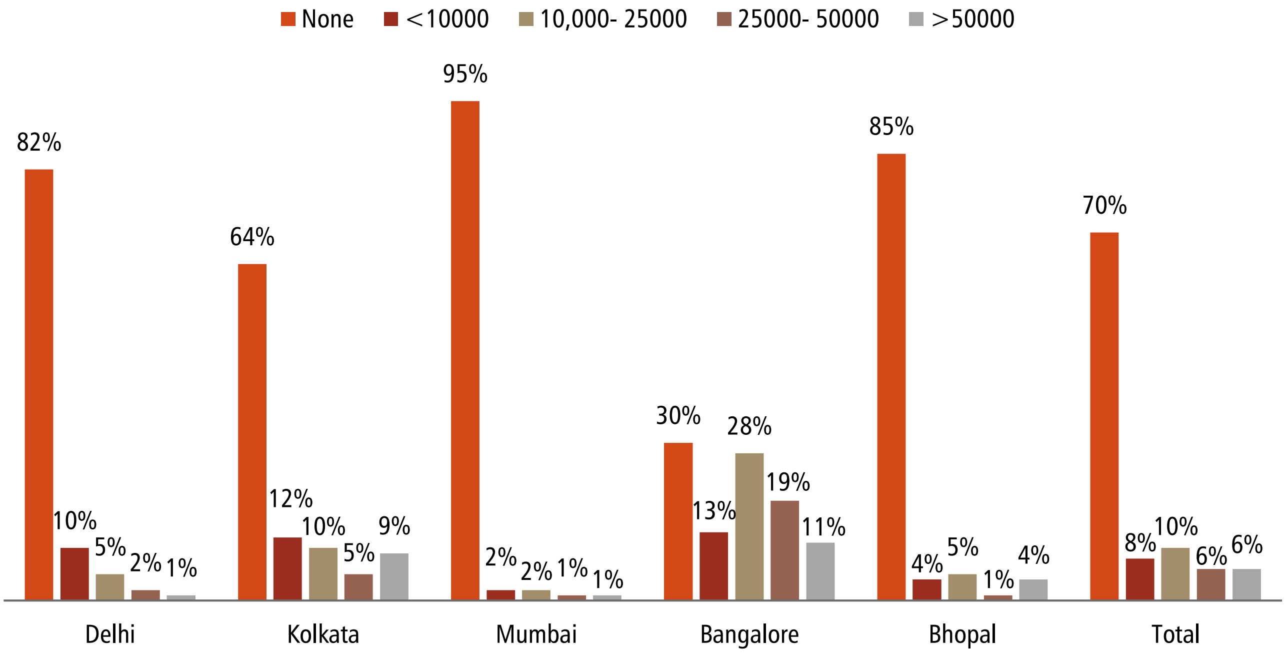
Figure 5: Consumer Durables Bought in Cities



Source: ICRIER survey

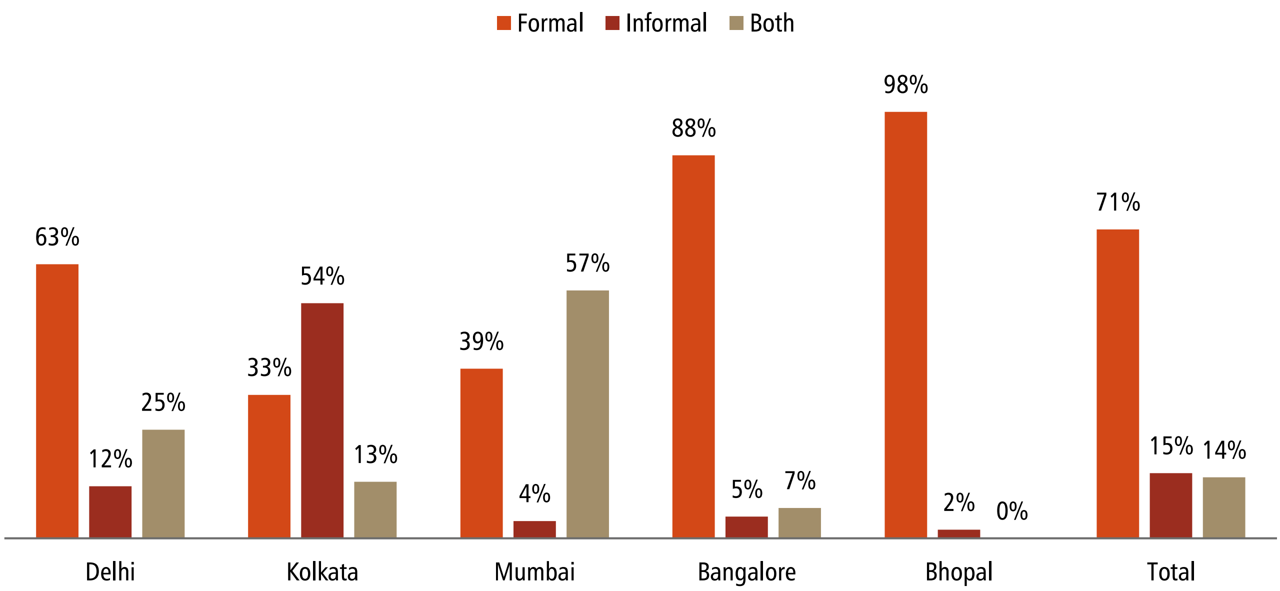
asked about the overall debt of the households. When other forms of outstanding debt is considered, it was found that much of the debt originated from formal sources. In Bhopal, 98% of participants reported that they had taken loans from formal sources while for Bangalore, the corresponding figure was 88%. Out of the respondents in Kolkata, 54% reported that they took most of their loans from informal sources. The source of the loans is reported in Figure 7.

Figure 6: Quantum of Consumer Loans - Cities



Source: ICRIER survey

Figure 7: Source of All Loans - Cities



Source: ICRIER survey

The respondents were also asked whether they had had any difficulty getting such loans and overall, 74% said that there had been difficulties in getting bank loans. The corresponding percentage of respondents who had faced difficulties in taking loans from NBFCs was significantly lower (8%). When asked about the kind of difficulties they faced, no clear factor emerged, for either kind of institution. Overall, almost three-fourths of the respondents cited a lack of clarity in procedures, in both kinds of institution. Overall, 29% respondents said the other difficulty they faced was with extensive paperwork that banks required; just 8% of respondent reported difficulties with loans from NBFCs. Some respondents also mentioned unhelpful behaviour by shop owners and delays in getting the amount released as difficulties faced by them; respondents did not face such issues with banks.

With respect to mode of repayment of loans, 95% of the respondents said they paid off loans through bank account debits. Banks used by agents and by merchants at the point of sale were also widely used. When respondents were asked whether they were open to taking consumer finance from NBFCs in the near future, 76% of the respondents said they were willing. In Bhopal, 98% of the respondents said that they were likely to avail consumer finances in the near future. Nine out of every ten respondents in Kolkata said that they would take loans, while in Mumbai, almost half of the respondents gave a negative reply.

The respondents were asked where they had heard about bank loans and loans from NBFCs. Overall, 81% of the respondents got their information about the bank from their retailers, while the corresponding figure was 73% for NBFCs suggesting the important role played by publicity at the point of purchase (POP). Another 19% and 23% people got information about banks and NBFCs, respectively, from their relatives or friends.

Concluding Remarks

Financial inclusion has emerged as one of the most critical development challenge. For a country like India, with a large unbanked population this is particularly so. Schemes like the PMJDY, *Aadhar* etc., are greatly aiding this goal of the government. While there have been many recent efforts towards financial inclusion by the RBI as well as the Government of India, there are many challenges still: it is in this context that NBFCs can play an important part. This opens up an unprecedented opportunity for all players in the financial market including consumer finance companies.

While the market for consumer goods is constantly evolving and expanding into hitherto untapped sections of society, there are also a large number people getting integrated into the formal financial market. With the increased use of technology and digital intervention, not only are new players entering the market, but existing players are also diversifying their products. This intensifies the competition as the same segment is being targeted by many players.

Personal loans have grown at twice the rate of growth in personal disposable income, leading to a steady rise in household indebtedness. At the end of March 2016, Indians owed Rs 25.2 lakh crores to banks and the listed NBFCs, up 65% in the past three years. Outstanding personal loans are now equivalent to 18.3% of India's national disposable income, up from 15% in FY2014 and a 10-year-low of 14.1% in FY2012. According to the RBI, in the past three years, personal loans or household debts have grown at a CAGR of 18% against 10.2% CAGR in India's gross national disposable income (at current prices) during the period. The RBI has raised concerns about the growing share of final consumption expenditure (private and government) in India's incremental GDP growth, in its Annual Report for FY2017 (RBI, 2017d).

This may result in higher household indebtedness that may threaten the sustainability of India's growth model in the longer term.

From the consumer survey presented in the report, which captures only a very small slice of the populace, several important messages emerge. Firstly, there are many important differences among the cities. Indeed, there is appetite for more credit in cities which are relatively more underserved. The other important finding is that for most people taking a loan, publicity at the point of sales, helps in decision-making.

For the poor, managing money is central to their life, more than any other group (Collins et al., 2009). For such people particularly, clarity of procedures was a daunting challenge. This brings to the fore, the importance of financial literacy. This is the key to achieving greater financial inclusion in the country.

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89%

Of the respondents are having Bank account

76%

Are open to consumer finance

54%

Have bought any consumer product in the last one year

38%

Of the respondents use financial apps

Indian Council for Research on International Economic Relations (ICRIER)
4th Floor, Core 6A, India Habitat Centre, Lodhi Road, New Delhi-110003
Phone: +91 11 43112400 | Fax: +91 11 24620180 | www.icrier.org