Factsheet: Importance of Consumer Behaviour for Financial Inclusion

-Alreena Pinto, IFMR LEAD

Despite the availability of formal services, a large number of consumers especially in rural areas continue to opt for more expensive informal sources. Behavioural tendencies like the mistrust of formal sources, hyperbolic discounting tendencies, lack of self-control when it comes to saving adequately and even a poor understanding of the financial products offered are important factors that influence their choices.

Current Landscape

- Financial service providers acknowledge the importance of adopting customer-centric business models designed with an eye on customer's needs, preferences, and behaviour.
- Led by the Jan Dhan Yojana, the current national financial inclusion mission is an attempt at an integrated approach towards promoting financial inclusion in the country. Nevertheless, while 147.1 million accounts were opened under PMJDY in a short duration (as of March 2015), over 85 million of these accounts (~58%) were tagged zero balance and remain dormant.
- RBI has granted 10 small finance bank licenses and 11 payment banks licenses to financial entities in-principle, as part of extending its financial inclusion agenda. These niche entities are expected to leverage their extensive distribution network to provide access to digital financial services and target alienated rural households. The next 18 months are extremely crucial for these entities, and are likely to raise unexpected challenges in operations and questions regarding their sustainability.

Indian & Global Experience

To attain comprehensive and sustainable financial inclusion, it is imperative improve our understanding of customers- starting from the factors that influence their preferences and decisions, to the context in which these decisions are taken.

1. Mitigating Present Bias in Financial Decisions

The following studies evaluate innovations in financial products and services that aim to induce consumers to make financial decisions in the present that will benefit them later.

- In a large-scale field experiment, researchers from IFMR LEAD utilized a pension instrument *(commitment savings product)* to understand the determinants *(demand-side factors)* of long-term savings among low-income entrepreneurs in rural and semi-urban parts of western India. Findings suggest that households are more likely to adopt instruments that give them a push toward making better decisions with immediate incentives having a greater impact on take up but not necessarily higher savings. In line with previous literature that documents similar behavioral biases in financial decision-making, it was found that household and institutional characteristics influence long-term savings behavior.

- A 2011 study by Karlan, McConnell, Mullainathan, and Zinman examined whether individuals saved more in response to reminders to save in Peru, Bolivia and Philippines where savers were sent SMS messages or letters with generic reminders to save or a specific reminder to save for a previously mentioned goal. The results revealed that reminders increased the amount of savings by 6% and specifically reminders referencing personal goals increased savings by 16%.

- Formalizing the human tendency to allocate funds to specific purposes, in eastern Ghana, the Mumuadu Rural Bank asked individuals about their savings purposes and provided an opportunity to open separate, parallel savings accounts labelled "education," "business," "housing" and other categories. A study evaluating this product found that savers with access to labelled accounts saved 31% more than their counterparts without access, especially in the savings accounts meant for education.

2. Commitment Savings to Achieve Goals

The following studies evaluate product designs that aim to solve the lack of self-control often exhibited by consumers by requiring them to save for the future.

- Karlan and Ashraf studied the commitment savings product, SEED (Save, Earn, Enjoy, Deposit), implemented by the Green bank of Carago in Philippines, which allows clients to withdraw savings only when their goal date or amount has been reached. The study found that women who attributed a lower discount rate to the future were more likely to open commitment savings accounts and after a year, were likely to have 81% more savings than those who didn't open the accounts. However, only 20% of those offered the commitment savings device accepted. Poor households may be particularly reluctant to restrict access to their already scarce funds. It is important to find products that help poor individuals increase savings and manage their cash flows at the same time. IFMR LEAD is currently piloting possible variations of a "contract-free" (soft) commitment savings product and impact on take up and usage.

- In Malawi, the Opportunity bank targeted the tendency of farmers to be unable to hold on to post harvest monetary gains and developed a savings product that allowed them to restrain expenditures and smoothen cash flows. An evaluation of this product showed that there was a positive impact on savings of the farmers and this translated to an improvement in agricultural input use, value of crop output and household total expenditure.

3. Economic Returns to Social Interaction

By increasing the social ties between individuals, development organizations may be able to expand or deepen their informal risk-sharing networks and help the poor hedge against individual or household level-risks. In a study conducted by IFMR LEAD's Centre for Microfinance, researchers tested whether one development intervention that involves constant group interaction in standard microfinance lending, builds social capital.

- The increase in social interaction among members who met more frequently was accompanied by increases in risk sharing between group members.
- Most significantly, default risk decreased for the groups that met more frequently – weekly group members were 3.5 times less likely to default on their loans compared to the monthly group members.
- Researchers conclude that in this case, default decreased, not because of the pressure to repay, but rather because individuals with enhanced social capital (weekly members) were more likely to share risk and make monetary transfers.

Conclusion

While the need for understanding consumer behaviour and preferences to strengthen successful adoption of financial services remains unopposed, intricacies involved with consumer behaviour span across various fields and are easily influenced by external factors as well. Answers to questions may often be undetermined and obtaining them may be a time-consuming and costly affair. Often, by the time conclusions are drawn, consumer behaviour may change making the research results redundant. Moreover, the external validity of these results and their replication in a global context with diverse cultures and economies of the developing world raises questions of the possibility of drawing large scale conclusions from these studies.

Nevertheless, a deeper understanding of the needs, behaviours, and preferences of low-income households can help ensure more efficient and targeted delivery of financial services. Going forward, a nuanced understanding of demand-side factors, backed by rigorous evidence from the field, can deepen the impact of large-scale supply-side interventions such as the Jan Dhan Yojana.