WORKING PAPER: DEFINING FINANCIAL INCLUSION PARAMETERS FOR NANO ENTERPRISES

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APRIL 13, 2022

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Chapter 1: What is Financial Inclusion?

Financial inclusion, in its broadest sense, refers to the delivery of financial services at affordable costs to all sections, including disadvantaged and low-income groups. According to the World Bank's definition of financial inclusion, it is an indicator that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way. Various organisations have contributed towards the definition of financial inclusion and they all converge into majorly speaking about means of access to a full suite of financial services, provided with quality, availability of timely and adequate credit at an affordable cost (World Bank, United Nations, Reserve Bank of India). Financial literacy forms a very critical part of defining financial inclusion, as reflected through National Centre for Financial Education's definition of financial inclusion which not only focuses on access to affordable and wide range of financial products along with services which comprises banking and savings related products, insurance products, pension products and investment products, but also regards financial knowledge, attitude and behaviour as key components as well. Thereby, as aptly summarised by an ongoing study of the RBI, which aims to publish an annual financial inclusion index for India, financial inclusion is a concept comprising of three prominent aspects of finance – access to finance, usage of finance and quality of finance.

Some of the key impacts of accelerating financial inclusion in India may be reduction in cash economy as more money is brought into the banking ecosystem, promoting the habit of saving, thereby increasing capital formation in the country and giving it an economic boost, direct cash transfers to beneficiary bank accounts, instead of physical cash payments, availability of adequate and transparent credit from formal banking channels in order to foster entrepreneurial spirit (Amol S. Khanvilkar, 2015). Financial inclusion, therefore plays a role in enabling economic growth and resilience, improved financial health, job creation and development.

It can be noted that financial inclusion is an area which has progressed in terms of approach and understanding. Almost a third of the world's adult population faces a challenge to get ahead without the financial tools they need to improve their lives (UN Secretary-General's Special Advocate for Inclusive Finance for Development, 2016). As the concept of financial inclusion evolves, the focus of financial inclusion goes beyond just having access or usage to financial services but also considers quality. Spotlighting quality indicates that the financial services are responsive and responsible, meeting customers' needs and capacities as well as are safe and customer friendly.

Financial Inclusion 1.0 refers to the late 1970s when microcredit developed into a proof of concept that poor and low-income households are bankable. Further, Financial Inclusion 2.0 talks about how microfinance institutions became scalable and commercially viable through information technology in the 1990s. Moving ahead, Financial Inclusion 3.0 now encompasses the idea of focusing on the low-income segment, the non-banked and lesser banked, and micro, small-and medium-sized enterprises (MSMEs) (Triodos Investment Management, 2019). Fin techs and the digital banking ecosystem play an integral part in accelerating Financial Inclusion 3.0. Fin techs serve a wider objective of reaching out to the unmet financial requirements of the segments of population which tend to not be a part of the core consumer target base of traditional and established financial services entities (Shekhar Lele, 2018). Some of the benefits seen of fin techs playing a role in financial inclusion are better customer service, such as better turnaround time, customised products for various kinds of consumers, reduction in operating costs and market opportunity (Triodos Investment Management, 2019).

Over the years, financial institutions only considered providing access to a bank account and short-term credit opportunities as wholesome financial inclusion (Temenos, 2019). However, we have seen a big wave of financial inclusion as a concept of access to credit and transactional accounts. However, apart from access to credit, financial inclusion has also been the understanding of additional variables such as financial literacy, insurance and social security products and adoption of digital transactions.

The importance of financial inclusion can be seen for broadly three major reasons: 1) Contributes to economic development through broadening the resource base of the financial system by developing a culture of savings, 2) Bringing low income groups within the perimeter of formal banking sector; financial inclusion protects their financial wealth 3) Financial inclusion also prevents the exploitation of vulnerable sections by money lenders by facilitating easy access to formal credit (Reserve Bank of India, 2013).

The necessity to promote financial health has also become particularly apparent during the financial and economic impact caused by the COVID-19 pandemic. This global crisis has exposed not only the vulnerability of those who are excluded from the financial system but also the need to ensure that those who are included can actually benefit from using financial services, including resilience in the face of shocks (United Nations).

Chapter 2: What does Financial Inclusion mean for nano enterprises?

According to a report by the UN Secretary-General's Special Advocate for Inclusive Finance for Development, globally more than 200 million small- and medium-sized enterprises (MSMEs) in alone lack access to finance, limiting their ability to grow and thrive.

India has around 63.4 million MSMEs in India, 99 per cent of which are micro enterprises with less than Rs 10 lakh in investment. The micro-enterprise category itself is characterized by heterogeneity, fragmentation and informalization. If we refine categories further, another separate grouping of entrepreneurs and enterprises can be carved out, which we can call nano-entrepreneurs.

Nano enterprises often tend to lack a designated place of work, which translates into being one of the reasons why it is difficult for them to get credit. This then compels them to reach out to private money lenders or informal sources of credit, which also charge a greater rate of interest.

Access to finance has been a persistent challenge in the journey of small businesses. In light of this, building innovating finance models can greatly enhance the chances of small businesses for availing credit and also allowing them to inch towards financial inclusion.

Another challenge faced by small business is sector is procurement of raw materials. This issue mainly occurs because the requirement of raw materials is of small quantities, partly due to small scale of operation and partly due to financial constraints. Furthermore, they do not have significant capacity to withstand the market fluctuation of prices of raw material.

High credit cost, lack of documentation, and distrust of the financial system in general are some common sentiments echoed by the small business sector.

Credit cycles in India are extensive, and the process of getting short-term financing from banks is relatively slow and tiring for nano entrepreneurs. Furthermore, rigid guidelines of banks may work against these small businesses who need relatively small loans. However, mobilizing small borrowers will play a significant role in achieving India's vision of becoming a USD 5 trillion economy by 2025.

An illustration of the plight of nano entrepreneurs can be seen through this narrative:

"Parvati is a nano entrepreneur with a savings account with the Mann Deshi Sahakari Bank. But whenever she needs money, she takes a loan from the local moneylender. One day, while buying vegetables at the weekly market, I struck up a conversation and asked her why. She

responded, "Yes, I know I am paying Rs 10 interest per day on every Rs 100 I borrow from the moneylender, which is exorbitant. But I do not want to take a loan from your bank because I require a loan in the morning and want to repay it in the evening or maybe next week. I also would like to take the second loan immediately. And all this flexibility is given to me by the moneylender and not by your bank."

Parvati has a bank account, so she may be considered as financially included. But the question remains if Parvati is financially integrated? Therefore, there lies a journey from financial inclusion of a nano enterprise towards financial integration which includes making products accessible and available but also make the useful and relevant.

Innovation can prove to be a critical element to assist in the evolution of financial inclusion for nano segment. Finance models such as returnable grants (zero interest, no collateral loan), loan disbursement based on history of high repayment rate (Nano enterprises if given access to capital to meet immediate needs and aspirations, use it widely and pay it back), short term credit facility and top up credit facility help in accessibility, availability, affordability and adequacy of credit to this group of enterprises.

Further on, generating awareness about financial literacy (including plethora of government schemes such as simplified KYC, no frills account, business correspondents, credit information availability, local credit assessment tools) is also an area to consider whilst defining financial inclusion in the context of nano enterprises.

Lack of extensive data of nano entrepreneurs – their business environment, geography, and demography may be one reason why financial products and services tailored for them are less in number. Therefore, there is still a constant need for financial services industry to cater to these enterprises with suitable products supported by appropriate technology.

Leveraging technology to support the mission for financial inclusion for nano enterprises can be illustrated through the following example:

"Let's say a small business is enabled to receive digital payments from its customers,"

"The acquiring bank will be able to view that merchant through its digital transactions. The bank can then use technology, artificial intelligence and data analytics to calculate the business's cash flow without needing to physically see its inventory. This means the bank can

view past turnover and predict future turnover, allowing it to risk-weight the business based on this intelligence.

"From there, "it's a short step to designing customer-focused products such as a credit facility, micro-insurance or alternative payment methods."

The need for addressing financial inclusion for small businesses has been acknowledged by initiatives like the State Bank of India creating a separate vertical with an exclusive focus on financial inclusion and micro markets especially in semi urban areas for better customer experience. Under this newly launched vertical, about 8,000 branches in rural and semi urban areas have been identified for providing specialised services to the micro segment and to also improve the turnaround time for quick sanctions and disbursement of small loans.

Chapter 3: Review of indicators to measure Financial Inclusion

The importance of financial inclusion is widely recognized and the need for a comprehensive measure that can be used to measure the extent of financial inclusion across economies has been acknowledged by various studies. A financial index helps in providing a robust and comprehensive measure of financial inclusion in order to take account of the current state of the financial ecosystem with respect to financial inclusion in an economy and also to monitor the progress of the policy initiatives undertaken to promote financial inclusion, and further rectify or add accordingly (ICRIER, 2008).

Individual components of financial inclusion have been addressed by many studies, however, a comprehensive index which helps understand the various aspects of inclusion is imperative to understand the true measure of financial inclusion and also to engage in a comparative analysis between geographies, particularly since improving access and use of finance is viewed as a key policy priority. Firstly, studies have seen to involve a comprehensive set of indicators which take into account the physical penetration of banks in a more inclusive manner (Sarma 2012; Dabla-Norris et al., 2015; Mialou et al., 2017, Seidman et al., 2005, Sarma, 2010, Chattopadhyay, 2011). These indicators represent the concept of availability of finance, which is termed as a critical element to measure financial inclusion. This idea suggests that financial inclusion can be increased through targeting at the continued development and wider availability of basic bank accounts offered by mainstream financial institutions.

The true extent of financial inclusion cannot be measured as only the availability of financial services, for example, just having a bank account may not necessarily imply that the account is well utilised on account of physical or psychological barriers. Also, despite having bank accounts, marginally banked people may not be making sufficient use of formal financial infrastructure and may be using informal non-bank services (Diniz et al., 2011; Kempson, 2004). Therefore, financial access may not be a wholesome measure of financial inclusion and may lead to misleading insights (Pham and Bui, 2019). There may be several consumers that are able to access financial products and services but they are not interested in or find no benefit from them. Therefore, further studies have developed the concept of financial wherein access to finance is no longer the key parameter to measure financial inclusion. Usage of financial products is the participation of both financial consumers (individuals and enterprises) and the financial ecosystem. This concepts spotlights on how, when and to what extent to consumers use finance, and the degree of financing (Sarma, 2008). The proportion of people having bank accounts and not adequately availing the banking services are under banked or marginally banked people. These people may not be availing banking services due to various involuntary reasons such as remoteness of banking outlets, voluntary reasons such as unaffordable conditions, negative experiences with the service provider. The appropriate measure considered for the usage dimension is the volume of credit and deposit (Sarma, 2010), (Chattopadhyay, 2011), (Sarma, 2012), (N. Cámara, 2014).

Most studies have encompassed access, usage and availability of finance as strong and indicative measures of financial inclusion. However, what can be seen missing in these assessments is assessing the quality of the financial ecosystem (RBI Financial Inclusion Working Paper, 2021). In order to achieve sustainable financial inclusion, quality of the financial setup needs to be taken into account which may include financial literacy, which plays a role in reflecting the understanding of consumers about finance and whether they are willing and able to take financial decisions that are beneficial to them (Nair and Tankha,2015).

As established above, financial inclusion stands on three prominent pillars – accessibility/availability, usage and quality of finance. However, these components could be unevenly distributed across geographies and therefore adding a geographical microscope to understand financial inclusion in various regions is also an important task to consider whilst measuring financial inclusion. Such studies help in understanding if socio economic components play a role in influencing the access, usage and quality of finance in a given geographical area (CRISIL Inclusix, 2018), (IMF Working Paper on Financial Inclusion for SMEs in Latin America, 2015).

Studies have encompassed various parameters to measure financial inclusions cross individuals and enterprises, including the MSME segment. However, due to the lack of data on the category of nano enterprises such as, what exactly are their characteristics, which geographies are they seen in abundance, how many of them fall under the formal financial arena, may result into financial inclusion measured by various indices being misleading for the nano segment. Therefore, a specific index which takes into account data specific to nano and parameters which are valid and practical in terms of availability, accessibility and usage of finance needs to be explored. For example, nano enterprises tend to require smaller amounts of credit on a regular basis. This may not be supported thoroughly by mainstream banks, thereby rendering availability and accessibility of finance as a mere theoretical concept for nano enterprises.

Chapter 4: Distilling Financial Inclusion parameters for nano enterprises

There are many enterprises at the bottom of the micro category having turnover in a few lakh rupees with negligible investment, such as small shops providing goods and services, operating hyper locally and catering to neighbourhood areas. Nano enterprises can be a local grocery store, saloons, small eateries and restaurants, auto garages, and laundry shops. They are often invisible from policy radar, furthermore, Covid-19 and subsequent lockdown has severely disrupted day-to-day operations of these enterprises. Lower aggregate demand and uncertainty across the consumption spectrum forced these enterprises either to scale down or shut down permanently (Kearney and CII, 2021), (deAsra Working Paper Defining Nano Enterprises, 2022).

When it comes to studying nano enterprises, there is no significant official number mirroring them, nor has any large-scale study been carried out to measure the distress of nano-entrepreneurs. Government support in the form of credit guarantee scheme has brought little relief to this section of entrepreneurs as many of them were either invisible or ineligible. The Consortium of Indian Associations (CIA), an apex MSME body representing around 50 MSME associations spread across the country, has demanded the government to create a separate ministry for micro enterprises for better focus and policy support. The challenges faced by nano enterprises need a special spotlight on them in order to be addressed affectively and swiftly. Therefore, the concept of financial inclusion for nano enterprises needs to be revisited through their lens in order to identify the interventions required to uplift the financial reach of this group. Whilst walking the path of financial inclusion, we need to evaluate financial wellness as an additional check – do nano enterprises

Whilst discussing financial inclusion for nano enterprises, the following model of four prominent areas can be used to understand the various parameters/indicators which align with these four aspects:

i. Accessibility

Accessibility in financial inclusion is highlighted by the measure of access to finance seen for nano enterprises. This measure precedes the actual usage of financial services. Measuring financial access is imperative to identify gaps in the theoretical framework and actual penetration of the financial system in areas where nano enterprises are present. Presently, the primary measurable proxy variables for financial access include number of bank accounts, number of bank branches and percent of enterprises with a line of credit. These account for the **physical penetration of the banking system.**

Financial literacy is an important aspect in the means of financial access. Various studies show that knowledge regarding various financial services factors had significant impacts on getting financial access. Basic knowledge regarding depositing and withdrawing money, interest rates highly affect the overall access to finance. Simplifying financial literacy is also an important avenue to explore. Educating nano entrepreneurs about basics of finance like input cost, revenue from investment, cash flow gap, how to manage receivables & payables is imperative to achieve financial literacy. Financial literacy would further help in generating more appreciation for digital finance amongst nano entrepreneurs.

Measuring the **degree of digitisation** and inclusion of nano enterprises in this ecosystem can be seen through variables such as ownership of smartphones, internet usage, measuring digital literacy.

In order to illustrate accessibility of finance, imagine a consumer base with a demand for savings account and credit in the form of small loans. However, with the lack of banking infrastructure and knowledge of the financial ecosystem, finance remains inaccessible to this consumer base, thus excluding them from the ecosystem.

ii. Availability

Availability of finance for nano enterprises primarily addresses the question – do nano enterprises have opportunities to receive the desired financial services and products? Nano enterprises tend to require smaller loans with lesser documentation processes. They tend to focus on day-to-day transactions and safeguarding savings. Availability of tailored financial products for nano enterprises such as co-lending partnerships between banks and NBFCs, tweaking lending models by giving collateral free loans, or loans based on past lending history with the loan beneficiary and assessing growth factors of nano enterprise to assess their eligibility for small loans. Such focused initiatives may help in gauging the availability of finance as a measure of financial inclusion amongst nano enterprises.

For example, nano enterprises looking for funding may not be a part of the MSME lending setup, however, with such lending opportunities availability of finance can be measured to determine how much credit is available to satisfy the demand side of credit for nano businesses.

iii. Affordability

Affordability of finance for nano enterprises highlights the need to examine if the cost of resources proportional to spending capacity of the group.

For example: Is the transaction cost for a nano entrepreneur burdening? Is technology being leveraged in order to reduce cost of banking? How are NBFC, FinTech, small finance banks' lending to nano enterprises?

iv. Adequacy

Nano enterprises tend to require smaller and frequent loans and therefore aligning credit sources with this nature of credit of nano enterprises is important.

Table of Indicators to measure Financial Inclusion of Nano Enterprises

Table 1:Table of Indicators to measure Financial Inclusion of Nano Enterprises

Sr. No	Indicator	Rationale - which A?	Concept	Potential Sources for Data
1	Number of deposit accounts held by nano enterprises per 100,000 persons	Accessibility	How many nano entrepreneurs have availed PMJDY?	PMJDY data
2	% Of nano enterprises using a debit card	Accessibility	As opposed to merely measuring how many have debit cards, how many using them is a better measure of their participation in the financial system.	RBI/NPCI
3	% Of nano enterprises possessing rupay card	Accessibility		SLBC
4	Number of ATMs per 100,000 persons (rural/urban)	Accessibility, Availability	Understanding the penetration of banking system- physical	RBI
5	Number of ATMs per 100 sqkm	Accessibility, Availability	Understanding the penetration of banking system- physical	RBI

6	No. of bank branches per 100,000 adults	Accessibility, Availability	Understanding the penetration of banking system- physical	RBI
7	No. of bank branches per 1000 sqkm	Accessibility, Availability	Understanding the penetration of banking system- physical	RBI
8	Number of current accounts per 100,000 persons (value< 20 lakh)	Accessibility		RBI
9	% Of nano enterprises who have availed government finance schemes	Accessibility, Availability	How effective have Mudra, Credit Guarantee Fund Scheme for micro & small enterprise (CGFMSE), NSIC, CLCSS towards financial inclusion goals for nano?	Mudra
10	How many % nano enterprises have taken a loan from NBFC & MFIs, small finance banks?	Availability, Affordability, Adequacy	Understanding the penetration of banking system- formal/informal	Not available
11	% Of nano enterprises availing loan in priority districts of NBFCs	Availability, Affordability, Adequacy	How many % of nano entrepreneurs receive loans in the favourable districts identified by NBFCs?	Approach Gromor like organisations to get data of pin codes/areas
12	Average number of financial products used by nano enterprises	Accessibility	How many financial products such as UPI, investments, insurance are being adopted by nano enterprises?	Derived from existing data/newer data sources
13	UPI, NEFT, RTGS, usage frequency (based on some receivable)	Accessibility	What is the current picture of digital payment penetration for nano entrepreneurs?	NPCI
14	Ratio of targets given to FIs versus achieved in Priority sector lending	Availability, Adequacy	Is there a gap between the allocation of and receiving of credit for nano enterprises?	Mudra
15	% Of nano entrepreneurs having internet subscriptions	Accessibility, Affordability	What is the degree of digitisation to facilitate digital banking?	TRAI
16	% Nano entrepreneurs with smartphones	Accessibility, Affordability		TRAI
17	% Of nano entrepreneurs who are financially literate	Accessibility	Evaluation of 1) Financial Knowledge 2) Financial Behaviour 3) Financial Attitude	Not available

18	How many nano enterprises have a separate business and personal bank account?		Nano enterprises tend to mix personal and business finances	Not available

Chapter 5: Conclusion

Financial inclusion has various levels of prominence wherein the larger picture talks about how financial inclusion is a key driver of reducing poverty and enhancing shared global economic prosperity. This is an important aspect for investors as economic growth is an indicator of increased revenues. Furthermore, financial inclusion is closely linked to several UN SDGs such as industry, innovation, infrastructure, quality education and gender equality. Examining financial inclusion in the context of growth for India, it plays a role in inculcating the habit of saving, providing formal credit avenues in order to eradicate the importance of local money lenders. Whilst many studies have illustrated various parameters to measure financial inclusion in India, for both individuals and enterprises, it is hard to differentiate from the already established indices if there are enough insights on the inclusion of the nano segment of the economy. Thus, a focused analysis is needed to account for nano specific data and gauge financial inclusion parameters against the specific needs and characteristics of these nano enterprises.

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