Economy Insight: A Synopsis of USAID Paper

Beyond Cash - Why India loves cash and why that matters for financial inclusion

FICCI Research ***May 23, 2016***

The importance of financial inclusion, based on the principle of equity and inclusive growth, has been engaging the attention of policy makers internationally. In India too, achieving universal financial inclusion is a priority objective for the Union Government and this has multiple dimensions. The national mission for financial inclusion in India envisages introduction of a transparent and efficient system of subsidy disbursal mechanism as direct cash transfers into the accounts of the end beneficiaries, via JAM trinity (JanDhan-AADHAR, Mobile). The aim is to curtail leakages and help the government better assess and augment social welfare schemes.

With the launch of the Pradhan Mantri Jan-Dhan Yojana (PMJDY) (over 200 million bank accounts opened under this scheme), supported by the Aadhaar framework (over 950 million Indians enrolled), and with over one billion mobile phone connections, India has made remarkable strides toward achieving universal financial inclusion. However, a major concern, despite this tremendous progress is that the use of digital payments in the country remains elusive. Market data indicates three critical factors responsible for this phenomenon:

- **Cash transactions a matter of habit:** As high as about 97 percent of retail transactions in India are conducted in cash or cheque

- **Few consumers use digital payments:** Only 11% of the consumers used debit cards for making payments in 2014

- **Few merchants accept digital payments:** Only about 6% of Indian merchants accept digital payments. This restricts consumers' from meaningfully utilizing their bank accounts and new digital payment tools.

The Reserve Bank of India (RBI) estimates that cash is an inefficient medium of exchange, costing the economy US$ 3.5 billion annually. According to the World Bank, India could save approximately one percent of its GDP annually by digitizing cash-based subsidies alone. Besides, digital payment offers multiple benefits to both consumers as well as merchants. Digital payments can help consumers and merchants spend their money more safely and securely and also build credit profiles for lending opportunities hitherto unavailable in the informal banking sector. It is therefore crucial that a widespread digital payments acceptance network be built in India.

To realize this objective, the Ministry of Finance (MoF), Government of India, and the United States Agency for International Development (USAID) brought together a coalition of over 35 key Indian, American and international organizations operating in India to seek solutions for expanding the retail digital payments acceptance network and address the related challenges. FICCI is the only partner chamber of this alliance. The goal of the MoF-USAID partnership is to identify, test, and scale innovative approaches for expanding the use of digital payments at 'point of sale', particularly among low-income consumers, which in turn would increase financial inclusion.

As part of this ongoing partnership, the USAID embarked on a study between July and September 2015 (conducted by Dalberg, a global strategic advisory firm) and recently released a report – 'Beyond Cash' that highlights the current spending and savings behaviour and perception of digital payments in low-income communities in India, and suggests ideas on how policy makers can accelerate the adoption of digital payments in the country. The study was conducted in six locations across four states and focused on low-income consumers and merchants across rural, semi-urban and urban areas.

Key Research Insights

The report captures the key findings from quantitative surveys with over 2500 respondents as well as from deep ethnographic research with low-income consumers and small merchants. The survey reveals that consumers and merchants who are presently using digital payment are highly satisfied with their experience because of the numerous benefits that this payment system offers like convenience, safety, ease of access to funds, high speed of transaction, etc. The respondents have also shown willingness to recommend others to adopt digital payment.

Also, both consumers and merchants recognize the problems associated with cash payments. Consumers find it challenging to manage odd value cash transactions for which they need to have exact change. They also find it difficult to track their monthly expenditure in case of cash payments. Similarly, merchants have their own cash pain-points. For them, safety of carrying and storing cash and managing change to return to customers are some of the major business challenges. These problems can be resolved with the help of digital payment and hence offer a significant opportunity for increasing digital acceptance among consumers and merchants.

However, awareness of digital payment framework among non-users of digital payment (both consumers and merchants) is still very low in India. So, there is an urgent need to create awareness about the benefits of digital payment among both these categories of people and measures should be taken to address the issues faced by them which restrict them from accepting this mode of payment.

The report mentions some of the major factors hindering the growth of digital payment among consumers and merchants in India, and offers suggestions to address these issues.

Issues faced by Consumers

- **Low interest in digital payments is often driven by lack of a digital store of value.** In India, people do not have enough opportunities to convert cash into digital, because either they do not earn digitally (almost 80 percent of consumers surveyed) or have the opportunity to save their earnings digitally. This restricts them from making transactions digitally.

- **Low penetration of merchant acceptance is a key barrier to adoption.** Many people do not use digital payment because there are not enough merchants around them who accept this form of payment.

Moreover, consumers often associate digital payments with high value transactions only, which impacts its wider use.

Recommendations for Incentivising Consumers

1. **Digitize Income and create opportunities for consumers to make digital contributions to micro-savings products:** The survey findings indicate that consumers who are paid digitally are more willing to transact digitally. The report therefore suggests that the Indian government should continue digitising direct benefit transfers, and incentivise organizations to make payments to their employees digitally. Similarly, research also shows that people who save digitally are more open to digital transactions. Therefore, it is recommended that banks and payment players should develop flexible and convenient micro-savings products for low-income consumers, enabling them to use digital payments.

2. **Digitize low value-high frequency transactions like transport:** Consumers who participated in the survey indicated inconvenience in using cash for low value, high-frequency, transactions. So, the government should consider digitizing mass transit and other public transport systems and expanding the use of such transport payment instruments to broader usage. Also, efforts should be made by banks and other digital payment players to create digital products which can provide convenience to consumers in case of odd value transactions. These products can have additional feature like easy-to-use expense tracking, which can further motivate consumers to use digital payments.

3. **Communicate specific use-cases and encourage trials among new consumers:** To generate interest in digital instruments, banks and payment players can focus their marketing and advertising campaigns on tangible, easy-to-understand, and specific use-cases. They can also encourage trials amongst new consumers by providing innovative incentives; for example, providing cash-back on a consumer's first five transactions can be effective. Moreover, current users should also be incentivised (as they have indicated satisfaction from using digital payment) so that they can share their experience with other non-users and encourage them to adopt digital payment.

4. **The report further suggests that the government can motivate consumers to expand their own digital payments use** by providing tax and monetary incentives. For example, this can be achieved by linking the usage of cards or mobile wallets to income tax rebates. Banks can also incentivize consumers to use and recommend digital payments by offering cash-backs or loyalty points.

Key Issues faced by Merchants

- **Merchants find it expensive to adopt digital payments, which affect their interest.** Merchants have highlighted high cost of trial as a factor driving down interest in acceptance of digital payments.

- **Merchants like consumers, are trapped in cash ecosystems, which inhibits their interest.** The second biggest reason which restricts merchants from accepting digital payment is their own requirement of making cash payments to their suppliers. However, merchants who do not pay by cash, use cheque for payment as cheques provide advantages of physical transaction, trail and latency. Also, lack of consumer demand is highlighted as the third major reason for low acceptance.

Recommendations to bring Merchants onboard

The report highlights that many merchants are comfortable operating in India's 'cash ecosystem' but are open to switching if cheap digital payment options are made available and they are incentivized for using them.

1. **Enable merchants to try digital payments at low or no cost:** As merchants find the up-front cost of trial for digital payments very high, banks and payment players can consider removing these fees and device installation charges and move towards pay-per-use models. This would encourage merchants to accept digital payments. Banks can also remove restrictions on minimum current account balances and simplify the onboarding experience of merchants. Besides, government can provide tax and monetary incentives for digital sales by merchants to incentivise them.

2. **Digitize retailer-to-supplier payments:** It is recommended that FMCG players provide incentives to retailers to make digital payments to their distributors. To give further encouragement, FMCGs can offer discounts and cash back guarantees to retailers on digitally sold goods. Since cheques have been found to be the second most favourite mode of payment, digital payment services should be deigned with features similar to those of cheques to make them popular among merchants.

3. **Build Credit Profiles based on transaction-based usage to incentivize acceptance of digital payments:** Given the large unmet demand for credit among small merchants, banks and payment players can collaborate with data analytics companies and credit providers to provide working capital and business investment loans based on the transaction-data generated by digital payments. Thus, credit can serve as an incentive for merchants to accept digital payments. FMCGs can also offer loans based on digital sales data to incentivize retailers to pay distributors digitally.