

How to Cite:

ArvindKhadse, A., & Dharmari, H. (2021). A study on formal financial services for rural small savers. *International Journal of Economic Perspectives*, 15(1), 285–296. Retrieved from <https://ijeponline.org/index.php/journal/article/view/48>

A Study on Formal Financial Services for Rural Small Savers

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Abstract---Formal markets are not interested in ensuring high-risk small savers. The reasons are both, theoretical as well as policy specific. Informal saving, in the form of assets, is readily responsive to high-risk conditions. But an adverse shock reduces the value and makes the terms of trade adverse for them. Secondly, the lumpiness of assets is also another reason why the poor cannot protect themselves easily against adverse shocks. Holding savings as cash in hand or with some trusted person is also not risk-free. In such conditions, small savings are considered as self-insurance and help in stabilizing income in the advent of shock. When all options of savings adopted by the poor are risky, what stops them from going in for formal small savings? Some issues are examined in this article.

Keywords---formal financial, rural small savers, self-insurance.

Introduction

Rural India is a paradox. The total rural population in India is estimated at 740 million spread over 700,000 villages, across a wide variety of regions and consumer groups. While there is a vast number of villages that are rapidly being engulfed by sub-urbanization, with a sizeable proportion of the rural population engaged in non-agricultural activities; there are a large number of villages that are reaping the fruits of an agricultural revolution. Improved methods of cultivation and diversified farming practices are providing them near urban income levels. On the other hand, there are also thousands of villages that are still inaccessible, without electricity or basic sanitation facilities, where the population enjoys no steady source of income and are regularly exposed to the perils of famine, flood, or cyclone.

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Submitted: 27 August 2021, Revised: 09 September 2021, Accepted: 18 October 2021

Given this situation, the general impression in the world is that rural India is poverty-stricken. The people in the rural areas after meeting their subsistence are left with very little income to save. But records reveal that the rural saving to income ratio at 30 percent is quite high, even higher than their urban counterparts. A study carried out by Forte, a research agency in India set up by the Dutch insurance and banking group, ING, reveals that rural awareness for some variety of saving and insurance schemes are quite high. Mostly, rural people go for life insurance as a means of long-term saving to meet long-term goals like purchasing land, consumer durables, or for family functions as a marriage of a daughter. In contrast, their urban counterparts save in life insurance schemes for availing tax rebates (Dionne & Eeckhoudt, 1985; Dahiya & Chaudhary, 2016). This contrast reveals that rural people go for long-term savings primarily for asset building or consumption expenditure. The first is for securing the future income risk while the second is a status symbol.

Status symbol is optional. But income risk is unavoidable and may result from shocks like economic fluctuations, climatic change, or internal, individual-specific shocks like illness, which cause severe hardship. Rural households are more vulnerable to these. They are exposed to a variety of risks like crop failure due to drought, flood and cyclone, death or illness of the livestock, policy shocks like fluctuating prices of agricultural produce, labor problem, and land-related issues. Rural households adopt a different types of strategies to avoid severe income and consumption shortfalls due to such eventualities. Asset building like the purchase of land, draught animals, and other livestock and cash in hand are the primary ones. Often they go for small savings (Besley et al., 1994; Deshpande, 2006). This article examines the constraints the households face in adopting these strategies and suggest a policy framework to expand the ability of the households and communities to cope with severe income and consumption vulnerability caused by risks in the rural economy of India. The study is based on the sample taken from the rural households from Mayurbhanj, a tribal-dominated district of Orissa.

The study contains eight major sections. After the introductory note, the second section highlights savings in rural India. The third focuses on the network of the formal financial institutions, especially banks, in India. The fourth section assesses whether formal financial institutions are averse to rural savers, while the fifth one examines the response of the rural small savers to formal financial institutions. The sixth one contains an empirical study and the seventh part discusses findings of the same and comes up with certain policy suggestions based on that. The last one is the conclusion.

Savings in Rural India

Nearly 70 percent of the rural population can save, but more than 50 percent save in the form of assets like land, livestock, or utensils. In many poor countries, poor people value savings so much that they are willing to pay to save. Roving deposit collectors in many countries charge a fee to accept cash from the clients—typically 6 percent of the average money balances. (CGAP, Portfolio, 12/2007). Financial services to the poor have always remained supply-driven, rather, credit-driven. Savings has always come a poor second. In the beginning, came the

agricultural credit, which came in the form of soft loans, and was given to small and marginal farmers who were considered to be poor. Then came the era of micro-enterprises which focused on women to alleviate poverty, women entrepreneurs were given large sums of working capital in groups with the joint liability of repayment. But despite these efforts, it remains unclear to what extent these formal financial institutions have been able to cater to the needs of the poor. As far as saving is concerned, these institutions have a perception that the poor do not save. This may be inferred from the low prevalence of saving mechanisms like accounts in financial institutions. However, the demand data for saving remains highly suppressed. The most compelling evidence of demand for savings services comes from the prevalence of deposit collectors to whom clients regularly pay some premium to hold their money. Just as the existence of a moneylender reflects the demand for credit among the poor, widespread use of informal saving services and physical assets signals demand for formal savings mechanisms. However, this demand could be tapped only when the formal service providers can offer the clients more attractive value propositions than they can obtain informally (Kumar et al., 2019; Ji, 2020; Low, 2005).

SHG movement in India has been harnessing the ability of the poor to save. Yet they have not succeeded in catering to the savings need of the poor. In a survey of SHGs in the tribal-dominated district of Mayurbhanj in Orissa, it was observed that the group members of SHGs preferred to contribute only the stipulated amount to the SHG fund. They were not willing to offer a larger amount to be saved in the fund for two reasons; firstly because all the members were not capable of doing so; second, they doubted the ability of the team leaders to manage funds, and felt that large unmanageable funds may lead to the difference among the group members and break-up of the group. Therefore, demand for savings services continues to remain unheeded.

Banking network in India

The Indian banking sector is gradually moving away from rural to urban areas. Over the last six to seven years, rural bank branches have shown a declining trend. But strangely, even though branch networking has grown urban-centric, the few operating in the rural areas have been performing remarkably well, with growing volumes of business. Share of the rural bank branches, which was nearly 50 percent in June 2000, has come down to 44.60 percent in 2006, with an absolute number of 32,709 and 30,754 in the respective years. This speaks of the growing disinterest of banks towards rural setup; much against the dictates of the RBI, they are closing down rural branches to move to the urban areas.

While the figures tell this story, the actual scenario is somewhat different. There are two possible explanations for this. First, due to increased urbanization, rural areas are being submerged in the urban township or being transformed into urban areas with diversified socio-economic scenarios. Second, bank branches when located in areas with a population below 10,000 were categorized as rural branches. With increased immigration of workforce in response to the development needs, population volume is increasing in the rural areas and rural branches are being recategorized as urban ones.

Despite shifting numbers, bank credit deployment in the farm sector over the two years from 2004-06 has increased from Rs 90,541 crore to Rs 1,72,292 crore, almost by 90 percent. But this does not speak of increased encompassing of the rural population because branch networking, as well as credit deployment, is much less than the demand for the same. In a recent speech, RBI Deputy Governor, Usha Thorat, said, the average population served by a bank branch has increased from 13,711 persons in 1991 to 15,209 in 2001 and subsequently to 15,680 in 2005. In March 2007, each bank branch in India, on average, was serving 15,900 persons and the figure in the case of Orissa is 16,500 (Economic Survey of Orissa, 2007) While the branches in the rural areas have been serving 13,462 persons in 1991, 15,667 in 2001 and 16,650 in 2005, the figures for the urban branches are 14,484 in 1991, 14,137 in 2001 and 13,619 in 2005. This speaks of increased demand for bank branches in rural areas (Data Source: Business Line, an e-paper from Hindu group of Publications, May 04, 2007).

The rural economy is prospering. With increased remittances from the urban dwellers and the shift of agriculture from subsistence crops to cash crops and commercial crops like horticulture and floriculture, savings from rural India have escalated by 30 percent over these years. Booming economic activities have also attracted private sector banks as well as non-banking financial companies. They are eyeing the rural economy to mobilize savings and strengthen their capital base.

Are formal financial institutions averse to rural savers?

Saving Assessments conducted by the Consultative Group to Assist the Poor (CGAP) has probed the problems faced by the formal financial institutions in extending savings services to the rural poor. These features are more or less prevalent worldwide. Firstly, saving programs need a more sophisticated managerial acumen than credit services. Mobilization of savings requires more capable staff and a well-knit system. These inputs often increase the cost of the savings services, as efficient management demands higher remuneration; supervision of small funds may pose a problem. Formal institutions could go beyond the existing norms and design supervision accordingly. Extension of financial services at a lower cost could be achieved by opening up branches in grocery stores, medicine stores, or even with grain dealers. Such a step has been successful in Mexico and the Philippines.

Secondly, formal financial institutions often face the problem of excess liquidity. This makes them disinterested in mobilizing savings, especially poor people's saving that is short term, unstable and costly. In Orissa credit-deposit ratio is very low (64 on March 2007), in comparison to the all-India average (75). This is due to a lack of suitable lending opportunities, which also causes excess funds with the Micro-Finance Institutions (MFIs). Less developed countries like Uganda also experience such problems (CGAP Survey).

In the third case, formal financial bodies, when in need, can get funds from the apex bodies like the RBI. Resource crunch is met by borrowing from another source, which is more convenient. These funds crowd out deposits, more so from the poor depositors. Another important limitation, which restricts saving mobilization, is the payment system. The formal institutions often lack accessible

locations to extend payment services and accept deposits. This can be overcome by the use of swipe cards with machines installed in retail shops giving access to banking services like deposits and withdrawal which have been successful in many countries (Ivatury, 2006).

It has also been observed that banking regulations that necessitate expensive infrastructure requirements discourage rural branch networking. This increased cost limits operation of the units in the rural areas. Moreover, the worldwide effort to combat money laundering and financing terrorism are making small transactions unviable for financial institutions (Isern et al., 2005). A public-private partnership, which could broaden the outreach of the banks, is severely restricted and regulated under the coverage of safety. In the Indian financial system, there is no institution, which concentrates on the acceptance of deposits only. When two jobs, deposit mobilization, and credit supply are to be taken up by the same institution, the former gets marginalized.

Are rural small savers averse to formal financial institutions?

The preference of the small savers varies across the markets. Yet, generally, they opt for easily accessible and secured funds. Accessibility can be two-dimensional: physical accessibility or proximity and financial accessibility or affordability. In this sense affordability also reflects liquidity. If a bank branch is located within five kilometers of a saver's residence it is said to be proximity. On average, in 2007, there were 0.015 bank branches per square kilometer in the district of Mayurbhanj and for the state of Orissa, the figure was 0.018. These branches comprise the totality of commercial banks, both public sector and private sector, cooperative, and regional rural banks. Moreover, each bank branch serves nearly 13,457 persons in the state while in the district the figure is 4,182. This, however, is not surprising. This poverty-stricken and tribal-dominated district has a large number of bank branches. CGAP has observed that in the Philippines the correlation between the number of subsistence poor and the number of people per branch of deposit-taking institutions in different regions was 0.68. In Mexico, the correlation between the number of people per branch and the level of marginalization in different states was 0.62 (CGAP Focus Note No 37, September 2006). Across the districts of Orissa as well the correlation between the percentage of poor people below the poverty line and the number of people served by a bank branch is 0.59.

Proximity-wise, informal sources of saving far out-compete the formal institutions. Small savers have found no substitute for saving at home like cash in earthen piggy banks or wooden boxes. They also prefer to keep cash with a relative or a well-known villager. Saving in this form is always liquid. With easy access, it carries no extra cost to the saver in terms of time or travel. Affordability measures the transaction cost of saving. This comprises travel costs plus wages sacrificed during the visit to a bank branch. Small savers pay some service fees to the deposit collector to hold their money or save the same in the bank. At times this amount converts the interest proceeds to around a negative 5 percent. All these costs taken together make formal saving unaffordable for the poor, who ultimately opt for informal saving. This apart, the threshold cost of deposit like the amount needed for opening an account, the minimum balance, etc. are often

more than what the poor can afford. A CGAP study reveals that the threshold cost decrease as branch density, i.e., number of branches per population increases. So widening the branch network could be a possible option. In the affordability aspect also small savers prefer low-cost informal savings.

Informal saving is risky. There could be lost due to fire, theft, or other hazards. Money saved in the form of livestock or land may face value reduction. Formal banking is also not free of risk so far as bank failure or absconding of the depositor along with people's money is concerned. Studies have observed that informal saving is far riskier than formal ones (Wright & Mutesasira, 2001). Even though risky, informal saving outweighs formal saving. It is a common notion in behavioral finance that individuals underestimate familiar risks or those risks they perceive to be under control, while unfamiliar risks, which are not perceived to be under their control, are treated as high risks. Therefore, the poor undermines the risks associated with cash at home, savings in the form of utensils or livestock, which they are well acquainted with since childhood. These risks seem to be less when compared with saving in an unknown institution with an unfamiliar system. In this aspect also small savers prefer informal savings.

There are many reasons why people feel insecure about formal saving. The much accepted 'Peerless' also failed at one time. There are also instances where companies come up with attractive offers ranging from utensils and decorative items to TV sets and motorbikes, collect savings from the people with the assurance that the product will be given to them when their savings will accumulate after 6 to 7 months. These agencies are often dubious companies who deceive the small savers in rural areas, who are not very knowledgeable about banking practices. This leads to a loss of faith in the practice of deposit collection. The rural small savers are ignorant about the reputation of the FIs. Even if they know they find it difficult to access them (Lee, 2001; Saravanadurai & Manimehalai, 2016). They are averse to the procedural delay and documentation involved in creating a savings account and withdrawing money from the same.

Model specification

Formal markets are not interested in ensuring high-risk small savers. The reasons are both theoretical as well as policy specific. Bell (1998), and Besley (1995), have investigated what these reasons are in their study. Informal saving, in the form of assets, is readily responsive to high-risk conditions. But a common adverse shock reduces the value and makes the terms of trade adverse for these. Secondly lumpiness of assets is also another reason why the poor cannot protect themselves easily against adverse shocks. Holding saving as cash in hand or with some trusted person is also not risk-free. In this event, small savings come up as self-insurance and help in smoothening income in the advent of shock. Then what constrains them in going for formal small savings?

Data specification

A survey was conducted to assess the impact of micro-finance on the economic position of the poor in Baripada. Data was also collected on savings along with the credit position of the households. A sample of 200 households, comprising

SHG members (62 percent) and non-members (38 percent) were included. It was observed that, on average, the sample households were saving nearly 39 percent of their income. It was also observed that almost all the sample respondents were more interested in informal savings like saving cash or in kinds like livestock, utensils, or land. The survey encompassed only female respondents, as primarily, they are members of SHG. They were asked about the family particulars and other details, listed in Table I.

Table 1
Mean values for demographic and economic characteristics of the sample

Sr No	Variables	SHG Members	Non-Members	Total
1	Total Annual Income (Rs)	43,000	36,000	41,000
	i. Primary Income (Rs)	34,000	33,000	33,050
	ii. Secondary Income (Rs)	9,000	3,000	7,250
2	Annual Saving (Rs)	18,000	15,500	16,700
3	Asset Position (Rs)	23,500	25,000	23,700
4	Indebtedness (Rs)	20,500	14,000	18,700
5	Dependents	6	5	4
6	Earners	3	3	3
7	Education (Years of Schooling)	9	9	9
8	Transaction Cost of Saving (per cent)	12	18	14

The sample households, on average, had an annual income of Rs 41,000. Families with SHG membership were able to earn some more income from the productive activities undertaken by some of the SHGs but this income was fluctuating.

Most of the sample households had agriculture as their primary occupation and their proportion with SHG membership was 65 percent and for non-members, it is 70 percent. The rests were daily wage earners or small shop owners, mainly with the family business. Almost all the sample households had some secondary occupation like working as wage earners or doing small business. But income from all these sources was highly fluctuating. Dependency load was almost equal for both, SHG members and non-members. This indicates that apart from himself, each earner has to support at least two more persons.

Average education measured as years of schooling was equal for both the groups, 9 years. Asset position like homestead land, agricultural land, livestock, and other agricultural implements was marginally higher (Rs 25,000) for the non-members than for the SHG members (Rs 23,500). It was also observed that among the SHG members 32 percent expressed their preference for formal saving while for the non-members the percentage was 24. When asked about the reason,

the members expressed distance, high transaction cost, and low accessibility to be the major reasons for not going for formal savings.

The model

In formal institutional saving, restraints like high transaction cost, security of funds, and distance of the formal institutions, etc. are many. Low access and less perceived safety in formal saving make the small savers averse to formal saving and substitute informal saving for this. To test the hypothesis a savings model was built up. The transaction cost of savings incorporates all three aspects: affordability, accessibility, and safety. It also considers the interest earnings and payment to the deposit collector. Various socio-economic parameters along with transaction costs are taken as the independent variables. The amount of informal savings is regressed on these factors. Formal saving is not considered, as very few respondents had this. Compulsory contribution to SHG groups was also not included as these are equal for all.

The model

$$S_i = \alpha + \beta_1 Y + \beta_2 A + \beta_3 Edn + \beta_4 Indbt + \beta_5 E/D + \beta_6 Os + \beta_7 TC + \varepsilon_1$$

Details of the parameters are enlisted in Table 2.

Table 2
Variables in the study

Sl No	Variables	Denotation	Definition
1	Income	Y	Annual Income
2	Asset	A	Family Investment plus Real Estate
3	Education	Edn	Highest Education in the household
4	Indebtedness	Indebt	Amount of Loan plus Interest
5	Dependent Earner Ratio	D / E	Number of dependents each earner has to support
6	Secondary Occupation	Os	Income from Secondary Occupation
7	Transaction cost of Deposit	TC	Amount spent for moving to the bank for a deposit

Empirical Results

Details of the regression results are given in Table 3.

In the sample survey, income and asset possession bear a positively significant correlation with informal saving. Education coefficient is not significant for saving by the sample household. A nationwide survey in Mexico revealed that the level of usage of informal instruments for saving decreases with an increase in education and income level (Bolano, 2005). Present survey evidenced that increased income level induces increased possession of the landed property and livestock like cows

and goats. Moreover, it was also observed that with larger asset possession they go for more assets as they consider these to be more income-earning and valuable than bank deposits. Indebtedness forces the respondents to save more. Those with the increased loan were also going for larger informal savings like cash in hand, as they could use it for immediate repayment. As expected, the transaction cost of formal deposit made small savers opt for more informal savings. On observation, it was noticed that interest-earning was not very alluring to the small savers. On adjustment with transaction cost the amount accrued often became negative.

Table 3
Regression coefficients with saving as the dependent variable

Variables	Model I (SHG)	Model II (Non-SHG)
Intercept	31.23	26.11
Income	48.31*	56.14*
Asset	36.33*	47.24*
Education	6.38	4.93
Indebtedness	8.94*	7.55*
Dependent Earner Ratio	- 6.57	-9.85
Secondary Occupation	9.54*	8.56
Transaction cost of Deposit	22.54*	17.93*
R^2	0.78	0.82
Number of cases	124	76

* Stands for statistical significance maximum up to 10 percent

Analysis and policy suggestions

This exercise has underlined income, asset possession, indebtedness, and transaction cost of formal saving to be statistically significant factors influencing savings in the informal form. The formal financial institutions if they want to out-compete the informal ones have to extend the web of savings facility. Undoubtedly, an increase in income and indebtedness increases savings. Improved asset position also induces the small savers to increase saving for debt repayment. But apart from these economic parameters, the formal financial institutions could reduce the transaction cost of deposits to broaden the reach. Members of SHGs could save because they can earn some income out of the productive activities of the SHGs.

The financial institutions, due to their inherent features, are not able to serve the small savers in rural areas. Small savers, on the contrary, opt for informal savings, as they perceive them to be less costly. Considering the demand-supply constraints and opinion of the small savers in one of the backward areas in Orissa, some policy suggestions could be made for encompassing the savers in the outreach of the formal financial bodies. Small savers, not only in the district but also in the state as a whole, were not well acquainted with formal banking services. The banking professionals have to address this. Incorporation of Micro-Finance Institutions (MFIs), NGOs, and SHGs in the process of deposit mobilization could be of many benefits to both the savers as well as bankers.

Earlier MFIs in India were functioning primarily as credit institutions and were not permitted to collect savings. In January 2006, RBI, recognizing the gap between the demand and supply of savings services, permitted deposit mobilization by the MFIs and christened them as 'banking correspondents'. This has opened up a new avenue of collaboration between formal financial institutions and MFIs/NGOs. Even the rural moneylenders, with detailed information about the rural clientele, could be appointed as banking correspondents. Such a step, while meeting the savings needs of the poor, will be advantageous for both the parties; as the financial institutions can broaden their resource base with access to new markets by incurring a little transaction cost, and MFIs, NGOs, and even rural moneylenders could have a broadened portfolio with a variety of financial products and gain a new source of income. And the rural poor will have a varied and robust channel of saving which will help them in coping with income risk and consumption risks with ease. Companies like 'Sahara India' have been a great success in this aspect. This model of deposit mobilization, which collects daily savings from the small shop owners, could be encouraged to encompass small savers as well. Existing customers could instill confidence among the new ones (Brehanu & Fufa, 2008; Ndiege et al., 2014).

Very often the small savers find the opening of a bank account and operating the same to be an uphill task. They are also not able to judge the financial risks involved in different saving instruments. They would rather prefer someone open an account on their behalf so that they could hand over their savings to the person and take it back when they need it, thus avoiding going to the bank. Banks could adopt a public education campaign in general and a client education program, in particular, to familiarize them with the variety of saving instruments.

To out-compete informal savings, formal institutions should offer affordable and secured savings services. The practice of interest slabs based on the income and asset position of the households could be adopted. Such a scheme is already in place in the credit market and these could be modified based on client preference and client needs. Mostly small savers are agriculturists or daily wage earners. Monthly saving schemes practiced by the banks do not fit into their earning pattern (Conning & Udry, 2007; Adams et al., 1986). They prefer a daily or annual saving scheme and formal institutions should look into this aspect. A credit-linked small savings scheme in which the small savers can borrow after depositing some amount could find favor with them.

Conclusion

Small savers do not find formal financial institutions comfortable to deal with. They prefer informal savings which however do not meet their demand in the event of a risk. This group, with their special requirement, needs special treatment from the formal bodies. If the latter could look into the intricacies and design saving mechanisms accordingly, it could not only extend risk coverage to the small savers but also broaden the financial base of the formal institutions and the numerous banking correspondents.

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