Rethinking Financial Management for Low-Income Households

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Abstract

The engagement of Indian households, particularly low-income households (LIHs), with formal financial markets continues to be low despite policy efforts towards financial inclusion. In this paper, we argue that this stems from a lack of proper understanding of their financial lives and, consequently, a lack of attention to what they might value. We further argue that as a result of this, the overall approach to offering products and services, including the design features thereof, fails to meet their needs and offer complete value in the manner that is required.

The paper starts by revisiting existing literature on the financial lives of LIHs that shows that they manage their finances in a rather sophisticated manner. This can be traced to the radical uncertainty they face, which includes a "triple whammy" of income problems and expenditure shocks that are frequent and unique to their circumstances. Therefore, day-to-day money management becomes an important feature of their financial lives, as does the inseparability of their financial lives from the socio-cultural contexts that they inhabit.

Having described the financial lives of LIHs, we show how the design features of two commonly offered product categories, basic savings bank accounts and life insurance products, do not map to their financial realities and are misaligned with their needs. Further, we argue that comprehensive portfolio-level approaches to offering financial products as an alternative to the current approach of offering individual products in a compartmentalized manner may also not be appropriate for LIHs. This paper underscores the urgent need for pertinent stakeholders within the financial services industry to actively engage with these ideas so as to engender meaningful financial inclusion.

Section 1 - Introduction

Financial inclusion has been a key policy objective in India for several decades, and more so in the last twenty years. Yet, despite efforts towards achieving this objective, the engagement of Indian households, particularly low-income households (LIHs), with formal financial markets continues to be low. This is evident from the underutilization of bank accounts (Klapper, Singer and Ansar 2021), the low allocation of resources to financial assets in household balance sheets, and the lack of uptake of non-credit products such as life insurance, retirement accounts, investments, and deposit accounts (Agrawal, et al. 2022).

Instead, to manage their finances, LIHs have been observed to employ approaches that are marked by a considerable reliance on informal systems. Here, informal systems comprise the networks of relationships LIHs maintain within and outside their community and a range of informal instruments that often go with those relationships (Reserve Bank of India Household Finance Committee 2017, Collins, et al. 2009). While several factors contribute to the current state of affairs, the lack of products and services that meet their financial needs in a meaningful manner remains a significant concern. Unfortunately, current approaches towards financial inclusion have not been able to address this issue. For example, one approach that is often seen as a solution is the sachetisation of financial products, such as through the introduction of micro-savings and micro-insurance products. However, reducing the size of existing standard market offerings does not necessarily address the issue, nor does it make for meaningful financial inclusion.

In this paper, we argue that LIHs' continued lack of engagement with the formal financial markets stems from a lack of proper understanding of their financial lives, and consequently, a lack of attention to what they might value. We further argue that as a result of this, the overall approach to offering products and services, including the design features thereof, fails to meet their needs and offer complete value in the manner that is required.

In the rest of the paper, we expound on our arguments in the following manner: In Section 2, we start by revisiting the existing literature on the financial lives of LIHs, which highlights that they face radical uncertainty, which includes a "triple whammy" of income problems and expenditure shocks that are frequent and unique to their circumstances. As a result, day-to-day money management takes centre stage. Further, the literature also points to the inseparability of the financial lives of LIHs from the socio-cultural contexts that LIHs inhabit. All of these factors make for the rather sophisticated manner in which LIHs manage their finances. In Section 3, we show how the design features of two broad categories of products, basic savings bank accounts and life insurance products, do not map to the financial realities of LIHs, and we argue that products and services often offered to LIHs are misaligned with their needs. Further, we argue that comprehensive portfolio-level approaches to offering financial products as an alternative to the current approach of offering individual products in a compartmentalized manner may also not be appropriate for LIHs. We conclude the paper with Section 4.

Section 2 – Low-income households and their financial lives

The financial lives of LIHs differ vastly from those of households at the middle and higher end of the income spectrum (referred to as "non-LIHs" in the rest of the paper). The differences arise from the disparate economic realities the "two" sets of households face, the disparate socio-cultural contexts within which they operate, and, consequently, the approaches to financial management they employ to meet their financial needs. This contrast can be observed in the number and variety of jobs LIHs hold, the number and variety of financial relationships they maintain, and, more importantly, the inseparability of socio-cultural context from the financial decisions they make. In the rest of this section, we rely mainly on the works of Collins, et al. (2009), Mas and Murthy (2017), Mas (2015), and the Reserve Bank of India Household Finance Committee (2017) to describe the financial lives of LIHs.

Section 2.1 – Radical uncertainty in the lives of low-income households

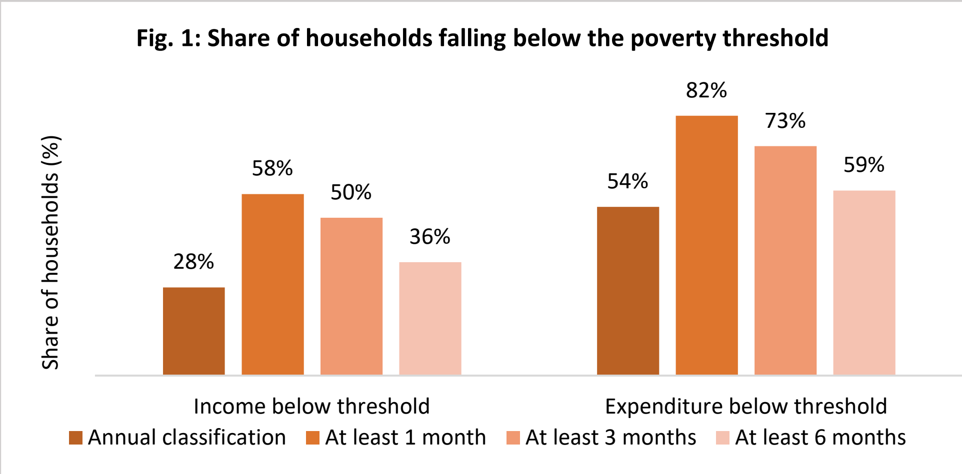
The lives of LIHs are far more uncertain than those of non-LIHs. LIHs have to contend with an unreliable employment scenario, live in precarious environments, and face far greater health risks. Consequently, they are more vulnerable to income and expenditure shocks.

LIHs mainly work in the informal economy, where employment takes the form of intermittent, part-time, and casual work, including self-employment. Examples include activities like running petty shops and home-based occupations, agriculture-related work, construction, domestic help, and, more recently, gig work. These forms of employment are prone to shocks for reasons that are often beyond the control of the households, such as the non-guaranteed nature of employment and the unavailability of continuous work.

The analysis of LIH cashflows at a high frequency offers valuable insights into how these forms of employment affect their income inflows and provides a unique and insightful understanding of their financial realities. For example, data from sources like the Centre for Monitoring Indian Economy's Consumer Pyramids Household Survey (CMIE CPHS) allows us to examine household incomes with greater granularity than on an annual basis, uncovering income fluctuations within the year. Analyzing the data at a monthly frequency shows that households categorised as non-poor relative to a poverty threshold[1] on an annual reckoning may experience episodic poverty for certain months of the year. This is seen when the annual threshold is converted into a monthly threshold, and the monthly income or expenditure is assessed against it (as seen in *Figure 1*).

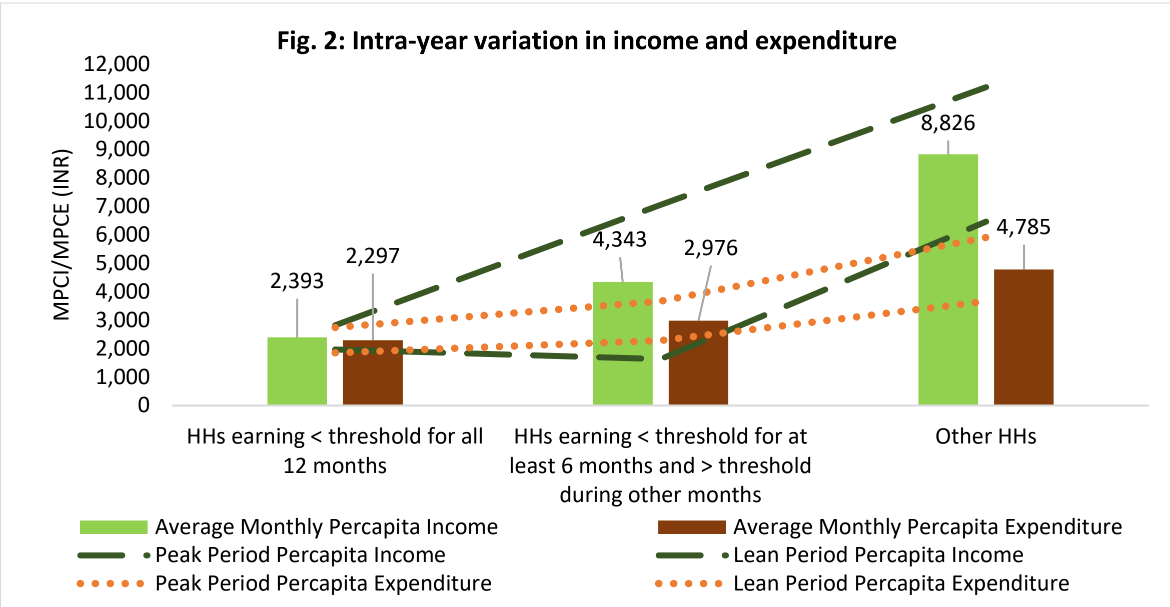
Figure 1 presents the share of Indian households falling below the poverty threshold in 2019 using two different approaches - 1) an annual classification, which categorizes households as "poor" by comparing annual income and expenditures to the annual poverty threshold, and 2) a monthly classification, which categorizes households as "poor" by comparing their monthly income and expenditures to the monthly poverty threshold. For the latter, the figure further categorizes households as those falling below the poverty threshold for at least one month, at least three months, and at least six months in 2019.

[1] The poverty threshold chosen in Figures 1, 2 and 3 is the minimum wage recommended by the Anoop Satpathy Expert Committee to Fix the Minimum Wage. Accordingly, the monthly per-capita threshold is INR 3,393 (USD 146) for rural and INR 3,882 (USD 167) for urban households (Ministry of Labour & Employment Expert Committee 2019).



Source: CMIE CPHS (2019)

Moreover, the monthly analysis shows that for households consistently below the poverty threshold throughout the year, with monthly income below the monthly threshold for every single month of the year, insufficiency of income is the primary problem to be solved. As seen in *Figure 2*, for the segment of households that earn less than the poverty threshold for all 12 months, expenditure is constrained by income in both peak and lean periods[2], indicating a lack of cash flow surplus. Their average income is close to their average expenditure, making it potentially challenging to meet larger known expenditures or emergencies or achieve any significant savings. On the other hand, for the segment of households that earn less than the poverty threshold for at least six months, instability of income emerges as the primary problem to be solved. For such households, peak period income is significantly higher than their lean period income.

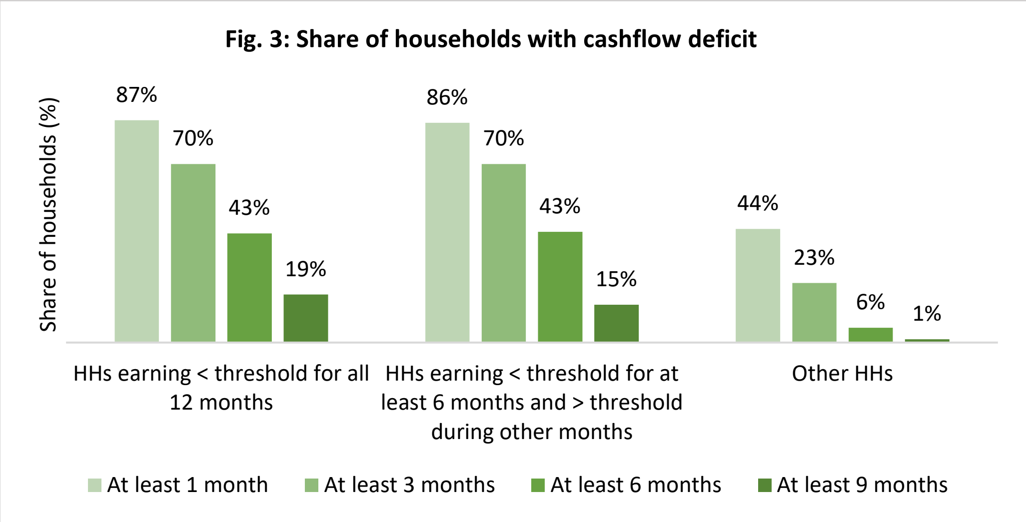


Source: CMIE CPHS (2019)
Note: MPCI refers to Monthly Per Capita Income, MPCE refers to Monthly Per Capita Expenditure, and HHs refers to households

[2] Peak period income is calculated as one standard deviation (S.D.) above the mean income and the peak period expenditure as one S.D. above the mean expenditure. Correspondingly, the lean period income and expenditure are calculated as one S.D. below their respective mean values. These calculations are performed for each household segment.

While the primary problem faced by the two household segments may differ —insufficiency for one and instability for the other— both segments ultimately encounter both problems, leading to illiquidity or cash flow deficits for significant portions of the year (as seen in *Figure 3*). This is the so-called triple whammy problem of insufficiency, instability, and illiquidity (Merfeld and Morduch 2023).

Figure 3 presents the share of households experiencing illiquidity or cash flow deficits. It categorizes them into three segments based on the number of months they fall below the poverty threshold - 1) the segment of households (HH) falling below the monthly poverty thresholds for all 12 months, 2) the segment of households (HH) falling below the monthly poverty thresholds for at least six months, and 3) the remaining households.



Source: CMIE CPHS (2019)

Due to their far more uncertain lives, LIHs also face expenditure shocks that are unique to their circumstances and unlike those of non-LIHs in terms of frequency. These shocks may relate to health, their ability to maintain safe and secure living conditions, social events, or loss of cash and other household assets. When viewed alongside the income uncertainties they experience, one could argue that LIHs face *radical uncertainty*. This type of uncertainty differs from traditional notions of risk in that it implies indeterminate or incalculable likelihoods for events or outcomes.

Section 2.2 – The centrality of day-to-day money management

Having examined the nature of uncertainty experienced by LIHs in Section 2.1, we now turn our focus to understanding the attendant financial challenges they face. There are certain financial concerns shared by all households across income levels: 'Where will my next dollar come from?' which encompasses the concern of ensuring ongoing income; 'How can I keep on?' meaning the concern of sustaining payments or outflows that are regular in nature; 'What if…?' indicating the need for contingency planning. While these concerns are universal, they are magnified for LIHs due to the prevalence of radical uncertainty and the absence of adequate safety nets or access to suitable financial services. In other words, LIHs face significant challenges in meeting day-to-day and other expenses (brought on by both expected and unexpected events) and planning for future needs.

While the need to meet essential and regular expenditures, such as for food, shelter, clothing, utilities, and children's education, continues to recur, the likelihood of LIHs facing episodic poverty can mean that income inflows are either completely absent for specific time periods or that they may not match the value or frequency of such expenditures. As a result, for LIHs, effectively managing day-to-day cashflows, both inflows and outflows, becomes central to maintaining the stability of income flows and ensuring expenditure (or consumption) smoothing. However, day-to-day money management is significant beyond just meeting essential and regular expenditures. In planning for contingencies and life goals, unlike non-LIHs, LIHs cannot separate or earmark money for such specific purposes, given the persistent need for liquidity. Money separation lines often get blurred for them, calling for optimization and a need for money to fulfil more than one need.

Essentially, LIHs must navigate their financial decisions to meet both planned and unplanned, large and small financial needs while accounting for radical uncertainty. This highlights the importance of effectively managing their cashflows on a day-to-day basis. In the following section, we examine how LIHs make and execute these financial decisions.

Section 2.3 - Financial decision-making and coping strategies

Stemming from differences in economic realities and differences in socio-cultural contexts, financial management for LIHs is different, too, from that of non-LIHs. The difference manifests in – a) the approach to financial decision-making and b) the types of strategies employed for the execution of these decisions.

In the case of non-LIHs, relatively stable income flows allow them to plan their finances in a linear manner. Generally referred to as budgeting, this exercise involves setting aside money for regular recurring expenses and drawing up a plan for allocating the remaining surplus towards life goals and emergencies. In executing financial plans, non-LIHs are more likely to rely on products and services offered by the formal financial system. Indeed, those products and services are designed for non-LIHs. The decisions related to the choice of insurance and savings/ investment products are generally arrived at after a careful analysis using the financial risk-return framework. With stable inflows, situations that call for revisiting decisions may not occur as frequently, allowing them to execute their financial plans with relative consistency. The planning horizon, therefore, is long, potentially stretching out to several years.

In contrast, the contexts within which LIHs operate change very rapidly. Therefore, drawing up a financial plan such as the one described for non-LIHs may not be feasible, given the frequent changes it may have to undergo. The planning horizon, therefore, is short, typically daily or weekly, depending on the frequency of change in the background context. As a consequence, the financial decision-making process is intuitive, automatic, and undocumented. Further, even if a linear planning exercise were to be feasible, we argue in Section 3 that formal financial products and services in their present form may not be able to accommodate the inability of LIHs to commit to consistent cash outflows.

The infeasibility of a linear financial plan, however, does not imply that the decision-making process of LIHs is erratic. On the contrary, it manifests as a complex set of *if-this-then-that* rules that allow LIHs to make decisions quickly in the face of rapidly changing circumstances. These rules, almost like heuristics, are of two kinds - *hierarchies* and *routines*. Hierarchies represent decision trees that help LIHs prioritize their financial needs, obligations, income, and liquidity sources and are tailored to different contexts. For instance, questions like which friend to call upon in case of a financial emergency or which expenses to prioritize in case of income shortfalls may be answered by hierarchies. Routines, on the other hand, are a set of default rules for managing money. Allocating money routinely for expenses such as food, utility expenses, school fees, and savings are a few examples. When hierarchies and routines are in place, and LIHs are able to activate them on a consistent basis, they give LIHs a sense of financial control even in the face of significant radical uncertainty.

To execute the decisions arrived at using the *if-this-then-that* set of rules, LIHs rely heavily on the informal system because it offers a kind of flexibility that rapid changes in context necessitate. The informal system comprises not only the network of relationships LIHs maintain within and outside their community but also a range of informal instruments. While the network of relationships could include family members, friends, neighbours, employers, shop owners, and other community members, the informal instruments may include local savings and credit groups, savings at home or with money guards, and borrowing from friends. The hierarchies and routines, as Mas (2015) describes, resolve into a variety of 'coping strategies' that may be categorized as follows:

1. **Income shaping** - This coping strategy includes mechanisms through which LIHs attempt to match their income flows with both recurrent and one-off larger expenditures. The objective here is to ensure the availability of predictable cash inflows. Mas (2015) observes that one of the ways in which LIHs achieve this is through income diversification, whereby additional income sources that meet their cash flow needs both in value and timing are sought to be arranged. LIHs may not always be successful at this, and further, income diversification almost always involves sacrifices on the part of the household. For instance, LIHs may work long hours or multiple jobs instead of one main job to supplement the household's income. By deciding not to pursue one single job in the short term, the household could be giving up on long-term future pathways where specialization may bring higher returns on goods produced or services rendered.

2. **Liquidity farming –** This coping strategy includes mechanisms through which LIHs seek to nurture potential sources of liquidity by continuously cultivating relationships within, and sometimes also outside, their communities. They may do this, for instance, through acts of generosity and belongingness to the community that invite reciprocity. While income shaping can help LIHs schedule liquidity, income instability inherent to informal forms of employment may not allow them to fully meet the goal of ensuring predictable cash inflows. Additionally, there may be emergencies that LIHs may not be able to meet if they solely relied on income shaping. In these scenarios, relationships can be leveraged for on-demand liquidity to meet shortfalls. For instance, a LIH may shop for groceries from the same store to build trust. This may hold them in good stead during times when they cannot pay for groceries and have to request shop credit.

3. **Animating money –** This coping strategy includes mechanisms through which LIHs exercise self-discipline – such as allocating money or savings to receptacles with specific assigned purposes or mentally assigning specific income streams to specific purposes. These mechanisms of self-discipline aim to store liquidity or to protect money from unwarranted uses. This does not simply mean that money is put away somewhere to be retrieved later, but more importantly, that money may be converted into valued receptacles that, by their very nature, act as "social or psychological barriers" that resist the temptation to liquidate. For instance, an LIH may convert money into jewellery or livestock and use mental labels to tag them as savings to be used only for specific goals such as children's marriage. Neither of these two receptacles – jewellery or livestock – is wholly illiquid or inconvertible so that an unforeseen emergency may still be provisioned for, but they do reduce the fungibility of wealth, which is held as cash that is easily reached for whenever a need is experienced. Similarly, money saved with a trusted employer (money guard) may be labelled by an LIH as savings for a specific goal but may also be used in case of an emergency.

The various coping strategies illustrate how the communities that LIHs live in come to play a critical role in their financial management. As a result, the financial and social lives of LIHs become intricately interwoven. Even the ordinary custom of gifting money during social events or visits and the corresponding obligation to return the gesture are constitutive elements in the financial lives of LIHs. Indeed, almost all social interactions among LIHs are embedded in these kinds of obligor-obligee relationships. Such relationships are constantly shifting while remaining culturally situated within specific practices that trade on reputation, social status, dignity, care, or other such factors. Indeed, a kind of informal social safety net may be the proper analogy here for describing the resultant of the various practices and strategies employed by LIHs.

Where non-LIHs differ from LIHs is not that the former do not participate in social networks or do not have social obligations and counter-obligations but that their lives do not involve the complex tapestry or interweaving of financial obligations and social obligations in quite the same way as do the lives of LIHs. This critical difference can be sourced in the nature of the uncertainty that LIHs face, which has already been described earlier.

Section 3 – Mismatch between financial reality and market offerings

Having discussed the workings of the financial lives of LIHs, in this section, we look at how a lack of understanding of the same impacts the approach to offering products and services to them, including the design features thereof.

Do the current product design features stack up?

We now take the case of two broad categories of products to demonstrate some of the ways in which the design of extant financial products and services may not be offering value in the manner that is required of them. It is important to note that this section is not meant to serve as a comprehensive commentary on the appropriateness of the design of all financial products and services available in the market.

1. **Savings bank accounts** – Owning a basic savings bank account is often seen as a gateway to deepening financial inclusion. Functionally, these accounts allow account owners to receive money, store money safely, make transfers and payments, and potentially, based on transaction records, become eligible for credit. In essence, with access to bank branches, ATMs, and digital money, savings accounts can prove to be useful money management tools. However, by mapping the functions of these accounts to the actual money management needs of households, we argue that in their functional design, savings bank accounts fall short in the value they offer to LIHs.

   As discussed in Section 2.3, money management for non-LIHs typically involves budgeting, allocation of money for different purposes, and employing various formal financial products and services to meet their needs. Undertaking recurring expenses is one of them, and in order to manage these expenses, the required sum is generally parked in savings bank accounts or as cash in hand. Viewed in this sense, savings bank accounts offer immense value to households whose money management is limited in scope and complexity – firstly, they need to mainly fulfil one purpose which is to facilitate payment for day-to-day expenses, and secondly, storing money in the savings bank account or transacting out of the account do not necessarily need to create value beyond immediate economic value. In contrast, as we have discussed so far, money management for LIHs has added dimensions and goes beyond just making payments out of a pre-determined budget. With a small and unstable pool of income, firstly, there is a constant effort to ensure money is available on a continuous basis to meet various expenses and is able to perform multiple duties, and secondly, operating within specific socio-cultural contexts, transactions invariably carry more than just immediate economic value.

Consider a woman from an LIH who sells flowers in the market for her livelihood. The business is not guaranteed to be steady, and therefore, income inflows vary on a day-to-day basis. While parking cash sales in the account may help ensure the safety of money, she may not have a compelling reason to store her income in the account for prolonged periods of time. In some cases, it may even prove to be a hurdle to efficiently managing money. On any given day, she may earn less than or close to the amount needed to meet day-to-day expenses or experience a good business day and earn more than the required amount. For example, on days when she has extra cash, she may, for instance, find it more beneficial to park the extra income earned with a trusted friend (money guard) who may make up for any shortfall in the money needed in case of an emergency. She may also lend the extra income to another flower vendor in the market to reciprocate the support she had received when her own flower stock on a particular day fell short of meeting her customers' requirements.

Essentially, there are two questions to consider here - 1) beyond the safety of money, can a savings bank account by itself offer fungibility of money across various financial needs (e.g. provision to park money with the facility to seek credit in case of a shortfall)? and 2) in providing the functions that LIHs may find relevant, can they be attuned to the socio-cultural context they operate within?

One could argue that this gap in value offered is also reflected in the adoption and usage of Pradhan Mantri Jan Dhan Yojana (PMJDY) accounts. Between 2011 and 2021, while bank account ownership significantly improved from 35% of adults to 78%, a closer look at the numbers reveals that 35% of the accounts were inactive – accounts with no deposits or withdrawals or any incoming or outgoing digital payments. In addition to not having enough money to use a bank account, the distance to financial institutions, lack of trust, and lack of need were reasons commonly cited for such inactivity. Even among adults who owned bank accounts and received payments in these accounts, only 47% used their accounts to also make payments, 28% saved formally, and 53% stored money using an account (Klapper, Singer and Ansar 2021).

2. **Life insurance plans** – A dominant product in the Indian life insurance market is an endowment plan. Unlike a term insurance plan that does not return the premium paid, an endowment plan offers life risk cover along with a savings component—upon the insured's death or the maturity of the policy, whichever is earlier, a promised sum is paid out. As bundled products, endowment plans allow money to perform more than one function, i.e. savings and insurance. While this is a design feature that may be of tremendous value to LIHs, these plans, in their current design, are ill-suited to meet the financial needs of most households and, more so, LIHs.

   Endowment plans require high[3] and regular premium commitments over long periods of time, a feature that does not align with the nature of cash inflows of LIHs. Further, while the savings component could potentially be a commitment device, upon premature surrender, life cover is severed, and high penalties are charged that result in loss of capital. This latter design makes the product illiquid and less fungible across various needs of the LIH (Ganesan and Prasad 2023). Consider, for example, an LIH that has bought an endowment plan that requires monthly premium payments and promises a lump sum at the end of 20 years, along with a life

[3] High relative to the life cover per rupee of premium they provide in comparison to term insurance plans.

cover. In the event of the household not having adequate social safety nets to cover various risks, including health risks, a health shock in the family can put the household's finances under severe strain. With no other financial recourse, if the family decides to surrender the endowment plan to pay for hospital expenses, it may stand to lose close to half of the amount saved as a penalty.

One could argue that this lack of appropriateness of endowment plans is reflected in life insurance persistency ratios. Persistency ratios indicate the percentage of business retained by life insurance companies without lapsing or being surrendered. For instance, the 13th-month persistency of the Life Insurance Corporation of India (LIC) was about 64 per cent in March 2023 – meaning 36 in 100 policies lapsed or were surrendered within the first 13 months (Insurance Regulatory and Development Authority of India 2024). Although these statistics relate to all policyholders, and not just those from LIHs, they are indicative of the latter's experience – as per CMIE data, around 35 per cent of households from the first five income deciles, i.e., households that earn up to around Rs. 11,000 per month, have reported using life insurance to save as of September 2023. Further, as per the All-India Debt and Investment Survey (AIDIS) 2019, the first five asset deciles save an average of around Rs. 7,500 per annum in endowment plans (Ganesan 2024).

The other category of life insurance product available in the market is term life insurance plans. While they are a better alternative to endowment plans in terms of the extent of life cover provided for the premium charged, as indicated earlier, these are pure protection plans that do not return the premium paid and offer only life cover. Faced with the triple whammy problem, LIHs may value having the premium money on hand at present more than paying for a product that would provide life cover in case of death, an uncertain future event. Further, the singular function, that of only life cover provided by term insurance, may not be valued by LIHs, given the multiple duties that they would like their money to perform.

Therefore, life insurance products typically available in the market do not offer functionalities that LIHs may value. Beyond financial considerations, there are also socio-cultural factors that determine whether life insurance as a product category is a priority for LIHs. When it comes to protecting one's family from risks posed by health emergencies or death, the tendency has been to rely on family and community to meet any financial shortfalls (Reserve Bank of India Household Finance Committee 2017). Additionally, behavioural factors such as optimism[4] and loss aversion[5] may also prevent them from purchasing insurance (Ganesan, Prasad and Sharma 2022). Culturally, too, the idea of death may be a sensitive subject to broach, even more so when money is involved.

Evaluating portfolio-level approaches for low-income households

Moving from our discussion of individual product categories and their ability to meet LIHs' financial needs, we now examine the overall approach typically recommended for effectively aligning financial products with a household's financial needs. We will compare this approach with our understanding of LIHs' financial realities.

A comprehensive portfolio-level approach is often seen as a better alternative to the current focus on offering individual products in a compartmentalized manner without considering how they fit into the overall financial picture of households. The comprehensive approach is believed to better enable

[4] Optimism in the context of life insurance refer to the tendency of people think positively about their chances of living a long life, or in other words, they do not think that the risk of death is high enough to buy insurance.
[5] With loss aversion, people do not want to lose the premium paid towards insurance, especially when the risk is not immediately perceivable.

households, including those with low incomes, to achieve their specific financial goals. It suggests that focussing solely on individual product categories may lead to suboptimal outcomes. Instead, it emphasizes the importance of considering the interactions between different products at a portfolio level, analysed through a risk-return framework. However, we argue that even this comprehensive approach has its limitations and potential drawbacks, especially considering the contextual realities of LIHs.

The initial step in the comprehensive portfolio-level planning approach commonly involves choosing the appropriate combination of products to align with the household's goals and priorities. This process, however, poses difficulties for LIHs. Their goals are often fuzzy; savings are often accumulated without any clearly defined purpose. Sometimes, rather than a well-defined goal, the focus may be on the instrument itself or on a proxy goal, such as accumulating cash savings or acquiring specific assets like livestock that get reared for another larger, lumpy goal. Moreover, the purpose(s) of these savings may frequently change based on changing circumstances, availability of funds, urgency of need or any other priority. As a result, there is no clear mapping between goals and the specific financial instruments designated to achieve them. Additionally, the conventional asset allocation strategy is not appropriate for LIHs. For non-LIHs, higher-risk investments are typically designated to long-term goals, with the expectation that these goals can better withstand market fluctuations over time due to their longer time horizon. However, LIHs face a unique challenge when considering the same approach. Their limited pool of funds often needs to serve multiple purposes, spanning various timeframes. This means that money must fulfil duties for both short-term and long-term goals simultaneously. Unlike scenarios where funds can be set aside specifically for a long-term objective, allowing riskier investments to weather market fluctuations and potentially grow sufficiently to meet the goal, LIHs do not often have the luxury of segregating funds in such a manner. This fuzziness between short and long-term goals adds to the reasons why the standard portfolio-level approach may be inappropriate for these households.

Section 4 - Conclusion

In this paper, we focus on the issue of LIHs' continued lack of engagement with formal financial markets. We argue that a lack of proper understanding of LIHs' financial lives, as is currently the case, has resulted in an overall approach to offering products and services, including the design features thereof, that fails to meet their needs and offer complete value in the manner that is required.

Meaningful financial inclusion of LIHs requires a nuanced understanding of their financial lives. This entails a recognition that their financial lives and, hence, their needs and preferences are distinct from those of households at the middle and higher ends of the income spectrum. Extant literature that closely studies the financial lives of LIHs documents the sophisticated manner in which they manage their finances. This sophistication is driven by the radical uncertainty they experience, which includes a "triple whammy" of income problems and expenditure shocks that are frequent and unique to their circumstances. As a result, day-to-day money management that can help achieve income stability and consumption smoothing takes precedence. Further, the inseparability of socio-cultural contexts from their financial lives stands out. All these factors do not allow them to plan and manage their finances in a linear manner that most non-LIHs with stable incomes are able to achieve. Instead, LIHs have been found to rely on rules-of-thumb decision-making frameworks and various coping strategies.

Taking the case of two broad categories of formal financial products, we demonstrate some of the ways in which the design of extant financial products and services may not be aligned with the financial realities of LIHs. Further, our analysis of the comprehensive portfolio-level approach to offering financial products highlights the additional shortcomings in the alternative approaches that the market has to offer. LIHs may, therefore, not find complete value in standard market offerings that are often more well-suited to meet the needs of non-LIHs.

This paper urges providers, policymakers, researchers, and other pertinent stakeholders within the industry to actively engage with these ideas, deepen our collective understanding of LIHs' financial lives, and foster the development of effective and viable solutions to address their needs. We identify the following research themes that warrant immediate attention – 1) Given the inseparability of socio-cultural contexts from the financial lives of LIHs, in what manner can formal market offerings be attuned to this reality? 2) The radical uncertainty faced by LIHs could challenge conventional models used by providers for designing products. These models rely on forecasting using probability distributions and historical data to predict future outcomes. To what extent are the formal financial markets able to model and accommodate this radical uncertainty that differs from traditional notions of risk?

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