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Financial inclusion - Building a success model in the Indian context

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Abstract

Financial Inclusion is the delivery of financial services at an affordable cost to hitherto unbanked environments, especially the low-income and under-privileged. The Government of India and Reserve bank of India have taken initiatives to spread banking services such as expanding the number of rural bank branches, allowing the banking correspondent model and adoption of CBS technology. While it is a daunting challenge in size and scope, financial inclusion is also a great social and business opportunity. An attempt has been made in this paper to study the various financial inclusion models used in India - the challenges and a way out.

Keywords: Financial Inclusion; Financial Services; Banking Correspondent; CBS technology; Lead Bank.

1. Introduction

Inclusion is the process of bringing in a loop the left outs and when it goes to Financial Inclusion 'It is the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. It is important to understand that a person with a reasonable access to all essential financial services is considered 'financially included' and merely one off access to some financial services for the sake of fulfilling the mandate of financial inclusion does not construe inclusion in

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the true sense. The problem of exclusion is not singularly faced by India but the whole world. Statistics show that 70%of the adult population of the emerging markets is excluded from the benefits of Banking, and when it comes to India the things are not too different. India has made enormous strides towards greater financial inclusion. At this stage, India has been adopting best practices from around the world that are relevant and is leveraging the nation's inherent strengths to accelerate the ongoing efforts towards greater financial inclusion—a critical social and economic imperative of the country.

2. Literature review

Financial inclusion has been a burning issue since last decade. A lot has been already discussed on it by the government officials, Reserve Bank of India and it has been a research point for the researchers all over the world. An exclusive committee was formed to address the issues of financial inclusion under the Chairmanship of Dr. C. Rangarajanand report was published in January 2008, on the work done giving a definition, the extent of exclusion, and the demand side factors. A website http://www.inclusion.in/ is available and a quarterly journal is published by, Skoch Development Foundation Established in 2008 giving all the details about the views of the Government, procedural changes done by Reserve Bank of India.

World scenario: The problem of exclusion has been faced worldwide and many have tried to tackle it with the sources available. The models used by various countries are the base for Financial Inclusion Plan in India. It may be worthwhile to have a look at the international experience in tackling the problem of financial exclusion.

South Africa: Strategy Used - No-Frills Banking: Basic bank accounts with negligible minimum deposit and a set number of free transactions.The key issue in South Africa was the very expensive banking markets to overcome this problem the central bank asked a collective of five banks to launch a 'Mzansi Account' a 'no-frill' bank account which facilitated five free transactions in a month, and as a result 6 million Mzansi accounts in a country of 32 million were opened (2009 report by the non-profit FinMark Trust). But all is not rosy. Only 3.5 million out of the 6 million accounts are active, the usage rate of only 58 percent.

Brazil: Strategy Used - Branchless Banking: Spread access to banking through agents called banking correspondents (BCs). BCs had existence in Brazil since the 1970s, but the active push came a little more than a decade ago with the regulation to broadened the range of services within the ambit of a BCs and ease in several other restrictions to increase the penetration of banking services in that country. As a result the total number of bank accounts doubled within a span of 8 years from 200 to 2008 from 63.7 million to 125.7 million thanks to 150,000 BCs account for about 62 percent of the total number of points of service in the financial system

Kenya: Strategy Used - Bank without a Bank: Use the mobile phone company as a conduit for keeping and transacting money. Kenya has demonstrated the best use of Technology for improving the inclusion. Increased use of mobile phones gave the opportunity to penetrate the banking market. M-PESA a banking ecosystem was launched by Safaricom-Vodafone with a cap of $500 on a transaction followed by M-KESHO a venture providing deposit facility. 40 percent of Kenya's adult population which comes around at 10 million became the client base of the service.

Mexico: Strategy Used - A Super-Efficient Lending Mission: A mission led by micro credit and allied products.
How a nonprofit based model can exhibit the importance of being extremely profitable for its shareholders was shown by Banco Compartamos, a microfinance unit, this with the combination of efficiency, innovation and a tight leash on costs and generated a base of 1.5 million clients even with interest rates being above 100 percent.

3. Financial Inclusion and Economic Development

Financial exclusion is a universal issue. A lot has been debated on the relationship between financial inclusiveness, economic growth and poverty reduction. It's a universally accepted fact that affordable access to financial services helps poor households plan for routine expenses, cope with sudden external shocks, better cover unanticipated expenses and also contribute to facilitate better access to more stable and productive activities. And there is a need that the financially excluded sections should be provided with products which are customized to their needs. It needs improvements within the existing formal credit delivery mechanism and evolves new models for extending outreach. Inclusive growth may also make poverty reduction efforts more effective by explicitly creating productive economic opportunities for the poor and vulnerable sections of the society. By encompassing hitherto excluded populations, inclusive growth can bring in several other benefits as well to the economy

4. Financial Inclusion - The India story

The term financial inclusion is not a revolutionary term for India. Though it is discussed more now than before. The roots were laid down in 1969 itself. But the awareness about the same and the necessary actions to promote the inclusion were very limited till 2005 since then it has got a boost for the benefits that it brings.
Reasons for financial Exclusion

- Poverty
- Unavailability of banking and other financial services.
- Complex procedures for availing financial services.
- Financial illiteracy.
- Traditional Cultural values
- Lack of faith in banking system

5. Evolution of Financial Inclusion in India

The process of financial inclusion has been carried out in India in phases. The Nationalization of banks was the first step taken for the purpose supplemented with institutional finance. The government strengthened financial delivery through cooperatives and by nationalizing banks and launching various innovative programs for generating self-employment and rural development as a result the branches of commercial banks and the RRBs increased from 8,321 in the year 1969 to 68,282 branches as at the end of March 2005. The average population per branch office decreased from 64,000 to 16,000 during the same period.

The second phase focused towards strengthening the financial sector through various reforms and change in regulatory norms during nineties. The highlights being Introduction of Self Help Groups (SHG) and bank linkages and Kisan Credit Cards, The focus was towards providing credit benefit to the masses. And it turned to be a good success especially for Women.

The current phase i.e. 2005 onwards has been explicitly a policy decision with greater emphasis on extension and coverage. Many initiatives are taken by RBI and Government of India to improve the position.

6. Models used – an overview

- **Lead Bank System:** Under the Scheme, each district had been assigned to different banks (public and private) to act as a consortium leader to coordinate the efforts of banks in the district particularly in matters like branch expansion and credit planning Under the scheme it was targeted that all villages above 2000 population will be provided access to financial services by March 2012. Villages below 2000 population will be covered in an integrated manner. Also to provide banking services to entire population residing in Urban and Metro Centers – Urban Financial Inclusion
- **Correspondent banking: The** Reserve Bank of India had, in January 2006, permitted banks to use intermediaries as Business Facilitators (BFs) or Business Correspondents (BCs) for providing financial and banking services. The BCs are allowed to conduct banking business as agents of the banks at places other than the bank premises. For the purpose, banks were permitted to utilize the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions and other civil society organizations.As per the recent norms various categories of individuals, kirana shops etc. and in addition corporate and for- profit companies are allowed to become Business Correspondents' of banks
- **Banking on mobile**: The mobile penetration is very high in the country, to make use of the opportunity the green signal from RBI was given in October 2008 and 32 banks were authorized to provide the facility. But still the object of achieving financial inclusion with the help of technology looks far beyond the target. To improve

the situation The Financial Inclusion Technology Fund was established with an overall corpus of INR 5000 million to create technology infrastructure with comprehensive credit information. And subsequently, mobile banking guidelines were also issued by RBI as mobile connectivity was thought of as a cheap but reliable model to reach out to the people.

- **Microfinance Model: There** are a variety of micro-credit models operating in India, making it the world's best laboratory for micro-finance. The model includes Microfinance system in India including Self Help Groups.

7. The support system: Measures by RBI and GOI towards financial inclusion

Use of Models is by no way sufficient till proper regulatory and policy changes are made in the financial system in the country. To increase the penetration of banking system in India, the Reserve Bank of India (RBI) and the Government of India (GOI) have been making efforts. The process started form Creation of State Bank of India in 1955 to the launch of The Financial Inclusion campaign 'Swabhiman' in February 2011.

Few of the key efforts taken can be noted down as

- Availability of a basic banking 'no-frills' account with low or nil minimum stipulated balances as well as charges
- To encourage people to open accounts, simplified Know Your Customer (KYC) norms with balances not exceeding Rs 50,000.
- Introduction of a General purpose Credit Card (GCC) facility up to Rs 25,000 at their rural and semi-urban branches.
- Establishment of Financial Stability and Development Council to institutionalize the mechanism for maintaining financial stability, as also literacy.
- Relaxation in some provisions of the Prevention of Money Laundering Act, only to enable and facilitate the opening of small accounts for poor people.
- RBI advised banks to formulate a board approved Financial Inclusion Plan (FIP) for three years up to Mar 2013. And RBI has urged all banks to include performance under financial inclusion in the performance evaluation of their field staff.
- A provision for UID (Unique Identity) number in the smart card
- **Swabhiman**: A program to ensure banking facilities has been launched to increase the demand for credit among the millions of small and marginal farmers who will benefit by having access to banking facilities with the help of UID. 83% people enrolled under the Aadhar Programme have responded that they would like to have bank accounts. The facilities provided for transfers of government subsidies and other payments will be used as well.

8. Inclusive growth in India

With all the available resources India has been trying to achieve the objective of 100 percent inclusion but the real picture shows something different.

Although the 2 year wise progress looks good but if compared with the target, it looks far beyond. Only 38 percent of the bank branches are in the rural areas providing coverage to 40 percent of the country's population.The aim to include a rural man is not really achieved as share of Rural branches is showing a declining trend over the years.It is intended to cover atleast73000 new habitations with a population of 2000 and above in a two years span but the actual coverage is only about 26000 villages just around 35 percent of the target in a year. In case of villages with population below 2000 the situation is worst as the coverage in a year is even less than 20,000. Further to add this coverage means including the services of BC's. If the opening of brick and mortar bank branches is considered the count is just around 1200. Further there are some regions in the country which lag behind in the number game, though the number of bank accounts is not a real indicator of financially included people. In the states such as Bihar, Orissa, Rajasthan, Uttar Pradesh, Chhattisgarh, Jharkhand, West Bengal and a large number of North-Eastern states such as Assam, Manipur and Nagaland, where the average population per branch office continues to be quite high compared to the national average of 16,000 people per bank branch. In case of new accounts the target set was 5 crore new accounts by March 2012, which was achieved and way above the target as well. But it seems just a number game. The proportion of operative accounts is very less. This hampers the basic object of use of financial services in real sense by the masses.

Financial Inclusion Plan- Achievements so far

Particulars	Year ended Mar 10	Year ended Mar 12	Progress-April 10 - Mar 12
No. of BCs/BC Agents Deployed	33042	96828	63786
Banking Outlets through Branches	21475	24701	3226
Banking Outlets through BCs	32684	120355	87671
Banking Outlets-Through other Modes	99	2478	2379
Total Banking Outlets	54258	147534	93276
No Frill A/Cs (No. in Millions)	49.33	103.21	53.88
Overdraft- No Frill A/Cs (No. in Millions)	0.13	1.52	1.39
BC- ICT Based A/Cs (No. in Millions)	12.54	52.07	39.53
EBT A/Cs-through BCs (No. in Millions)	7.48	21.76	14.28
KCC(No. in Millions)	17.63	22.34	4.71
GCC(No. in Millions)	.45	1.27	.82

Source: Presentation by Dr. K.C. Chakrabarty, Deputy Governor RBI, Skoch Summit June 8, 2012

When it comes to Microfinance institutions in India it has seen the journey from the poster boy to problem child. It started with a boom but the golden goose turned in to a black swine for various reasons and the dream of including the agricultural sector and lower group through credit facilities remained a dream. The excess inrush of capital into micro-finance led to phenomena of loan-pushing, multiple lending to the same borrower, coercive recoveries and very high interest rates (to satisfy demanding equity investors). Their ability to scale up and effectively manage risks remains weak.

All this happened as a result of difficulties faced during the implementation and lack of foresight while planning. The few causes of the failure being:

- Transaction Costs: Banks have incurred huge capital expenditure in the most advanced technology and sophisticated delivery channels and the problem that they face is simply from where to recover the transaction cost.
- Number of mobile phones – 403 million (as on April 30, 2009), of which 187 million (46 percent) do not have a bank account because of absence of adequate use of technology and the policies to support the same.
- Financial Inclusion is what Government wants banks to do and not what they want to do.
- Banks do not have liberty to choose their own model.
- Self-exclusion and bank rejection as analytical categories useful in empirical research about credit in different cultures

- Absence of viable Delivery Mechanism
- Not having a Business model

9. Way out

One of the causes as well as consequences of poverty and backwardness is inadequate access to all the forms of capital. Thus to look at financial inclusion in an isolated way is problematic. The focus on financial literacy should be the basic step and then reduction in poverty should be given equal attention. If financial inclusion has to succeed, the eventual benefactor from this game plan- the banks- have to make upfront investment in financial literacy and financial counseling, which becomes market investment for banks in the long run.

One of the main reasons of less use of services by the lower group is not having sufficient income itself. The problem can be tackled by providing sufficient income opportunities and financial inclusion can become the source of it but only if it is seen as a business model and not as an obligation to be fulfilled. The banks should be given enough space to select the appropriate model suitable to the working conditions of the bank.

With the high coverage of society it is possible to serve the unbanked and make a reasonable profit as the rule of economies of scale applies to it as well. The banks have the opportunity to increase the income from the fee based services and the example is already set by IDBI bank.

While public sector banks have achieved substantial broadening in branch outreach, their effectiveness has been constrained by high cost and inefficiencies, inadequate incentive structures, limited staff and inadequate technology use.

To grab the opportunity the infrastructure base has to be very strong. It needs a development in few areas:

- Delivery model is the key. What is needed is a complete eco system
- Introduce Products/Supply Chain focused Credit Facilities and Payment Instruments
- Introduction of appropriate credit facilities as well as payment systems and instruments in commodity markets and production chains/supply chains seems to be new entry points to improve access to finance and financial inclusion.
- Technology today has become an enabler for improving the reach of banks to the unbanked at an affordable price. Mobile banking has the potential of changing lives in a way that may be difficult to imagine. It can be done through various handheld mobile devices and other technologies that reduce cost and have the ability to record banking transactions and to communicate the record of such transactions to the Bank using the internet facilities / GPRS.

Though much focus has been given on increasing the no frill accounts but the real problem faced which is inoperativeness of the accounts has not been taken care of. The government has tried to overcome it by providing OD facility but it’s growing at a very slow rate. The awareness should be created to make maximum use of the facility by the poor. And further the facilities coming the umbrella should be increased and should not be limited to just opening a bank account and providing an OD facility of Rs. 500.

One cannot ignore the fact that MFIs did cross the last mile, did bring innovative practices and did contribute a great deal to financial inclusion. Killing the MFI industry will be a big setback for the financial inclusion agenda. The potential demand for micro-loans is huge and is still largely untapped. What’s required is a proper regulation of the units. Co-operatives can play an important role in the process. Agreed that the financial condition of co-operatives in last few years has created many doubts and lost the confidence of a common man. A bailout system for those in trouble can be an option because the benefits that come can be very useful in reaching the masses.

The difficulties faced while starting a new branch and convincing a new set of customers all together will be avoided as the basic problem of providing banking facilities in regional language plus investing in infrastructure including the human resources will be avoided completely. In addition it will come with the benefit of already having a good customer base, a brand image, and a human touch in banking as the care takers will be one of those from the specific masses. A strategy of takeover of cooperatives can work really well for the purpose.

10. Conclusion

The above research points to the importance of financial inclusion and highlights various policies that have been adopted in India to increase the same. Though all roads lead to Rome, the agenda needs to be more focused and should be more attentive towards the causes of the failure. From the study it can be concluded that efforts have been made to achieve the goal but for a diversified country like India it is necessary to bring the basics first, and customize the models as per the need, thus, will lead to financial development in a country which will help to accelerate economic growth.

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