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ROLE OF BANKS IN FINANCIAL INCLUSION - ISSUES & CHALLENGES

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ABSTRACT

An efficient banking structure can promote greater amount of investment which can help achieve a faster growth rate of the economy. World wise experience confirms that countries with well developed and market-oriented banking systems grow faster and more consistently than those with weaker and strictly regulated system.

India has, for a long time, recognized the social and economic imperatives for roader Financial inclusion and has made an enormous contribution to economic development by finding innovative ways to empower the poor. If we are advocating any kind of stability whether financial, economic, political or social and inclusive growth with stability, it is not possible to attain these goals without achieving financial inclusion.

Financial inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated mainstream institutional players.

Financial inclusion, prima facie to be viewed as "money at the bottom of the pyramid" and business models should be so designed to be at least self-supporting in the initial phase and profit-making in the long run. The banking sector has taken a lead role in promoting financial inclusion. Legislative measures have already been initiated in some countries like US, France, UK, South Africa etc.

Banks that have global ambition must meet local aspirations. Financial inclusion will also attract global market players ti our Country that will result in increasing employment and business

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opportunities. Technology is a great enabler and has to act as a ladder, with a human touch, to achieve the ultimate gold of providing Financial services to the financially excluded.

Banks have made appreciable progress in achieving the goal set for financial inclusion. The Indian experience has proved that Financial inclusion can work within the framework of financial stability given an enabling regulatory environment.

Introduction

According to Indian Banking companies Act, "Banking company is one which transacts the business of banking which means the accepting for the purpose of lending or investment of deposits of money from the public repayable on demand or otherwise and withdraw able by cheque, draft, order or otherwise,"

India has seen historic progress and growth in the past decade. While the growth story has been impressive, there are causes for concern on other dimensions. We have a long way to go in addressing concerns of absolute poverty. Low-income Indian households in the informal or subsistence economy often have to borrow from friends, family or usurious moneylenders. They have little awareness and practically no access to insurance products that could protect their financial resources in unexpected circumstances such as illness, property damage or death of the primary breadwinner.

Unrestrained access to public goods and services is an essential condition of an open and efficient society. It is argued that as banking services are in the nature of a public good, it is essential that the availability of banking services to the entire population without discrimination is the prime objective of public policy. Expectations of poor people from the financial system is security and safety of deposits, low transaction cost, convenient operating time, minimum paper work, frequent deposits, and quick and easy access to credit and other products, including remittances suitable to their income and consumption.

Focus on inclusive growth

There is a national as well as global focus on inclusive growth today. The financial stability and development council headed by the finance minister is mandated to focus on financial inclusion and financial literacy. All financial sector regulators including the RBI are committed to the mission and so are banks and other financial sector entities.

If we are advocating any kind of stability whether financial, economic, political or social and inclusive growth with stability, it is not possible to attain these goals without achieving financial inclusion. Financial inclusion promotes thrift and develops culture of saving, improves access to credit both entrepreneurial and emergency and also enables efficient payment mechanism, thus strengthening the resource base of the financial institution which benefits the economy as resources become available for efficient payment mechanism and allocation. Empirical evidence shows that countries with large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. Thus, financial inclusion is no longer a policy choice today but a policy compulsion. And banking is a key driver for financial inclusion/inclusive growth.

Role of Banks in inclusive growth

There are supply side and demand side factors driving inclusive growth. Banks are largely expected to mitigate the supply side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. Access to financial products is constrained by several factors which include lack of awareness about the financial products, unaffordable products, high transaction cost and products which are inconvenient, inflexible, not customized and of low quality. However, we must bear in mind that apart from the supply side factors, demand side factors such as lower income and /or asset holding also have a significant bearing on inclusive growth. Owing to difficulties in accessing formal sources of credit, poor individuals and small and micro enterprises usually rely on their personal savings and internal sources or take recourse to informal sources to invest in health, education, housing and entrepreneurial activities. Financial institutions like banks have an important role to play in overcoming this constraint, as pure business proposition.

Financial Inclusion Redefined

Financial inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at a affordable cost in a fair and transparent manner by regulated mainstream institutional players.

Though, banking services cannot be offered by MFI's/NBCs/NGOs, they have an immense and extremely important role to play in furthering financial inclusion in the sense that they bring people and communities into the fold of the formal financial system.

Objective

The broad objective is to take banking to all excluded sections of the society, rural and urban population. Though, the focus initially was to cover villages with population above 2000 by march 2012, banks have since drawn up their board approved financial inclusion plans to put in place a roadmap for extending banking services in all villages in an integrated manner over a period of net 3 to 5 years.

Paradigm Shift

It is not right to say that banks are not interested in increasing their rural penetration, instead they were constrained by their capacity/ability to do so till a few years back, in absence of appropriate banking technology. But by leveraging technology now, the banks are able to deliver to achieve the objectives/goals set for financial inclusion, which is going to be not only a big opportunity but also a bigger challenge for the banking system.

Viability of Financial Inclusion

We should also understand that poor people are bankable and there is tremendous potential for business growth by providing banking services to them. What is needed is an appropriate business and delivery model, because of the huge untapped market that is seeks to bring into the fold of banking services.

Financial Inclusion A Global priority

Several countries across the globe now look at financial inclusion as the means of a more comprehensive growth, wherein each citizen of the country is able to use their earning as a financial resource that they can put to work to improve their future financial status, adding to the nation's progress.

The banking sector has taken a lead role in promoting financial inclusion. Legislative measures have been initiated in some countries.

In the United States, the community reinvestment act (1997) requires banks to offer credit throughout their entire area of operation and prohibits them from targeting only the rich neighborhood.

In France, the law on exclusion (1998) emphasizes an individual's right to have a bank account. The German bankers association introduces a voluntary code in 1996 providing for an everyman current banking account that facilitates basic baking transactions.

In South Africa, a low cost bank account called 'Mzansi' was launched for financially excluded people in 2004 by the South African banking association.

Role of RBI in promoting financial inclusion

The RBI has adopted bank led model for achieving the set goals under financial inclusion. It has also leveraged ICT based Agent-Bank model through business correspondents for door delivery of financial products & services, mainly saving account with OD facility, remittance of funds, pure saving products and an entrepreneurial credit products such as KCC, GCC etc.

Besides, RBI has undertaken several other policy measures for success of the above model.

i. Relaxation on KYC norms
ii. Simplified procedure for opening of branches
iii. Free pricing of loans and advances
iv. Liberalization of business correspondent model
v. Opening of branches in unbanked rural centre's

Progress made by banks in financial inclusion

Banks have made appreciable progress in achieving the goal set for financial inclusion which can be evidenced from the following statistics:

a. Coverage of villages: Banks have opened banking outlets in 1.07 lakh villages as on June 2011, from 54,258 as on March 2010. Out of these, 22,870 villages have been covered through brick & mortar branches, 84,274 through BC outlets and 460 through other modes like mobile vans, etc.

b. Opening of No-frills accounts: As on June 2011 7.91 crore No-frills accounts have been opened by banks with outstanding balance of Rs. 5,944.73 crore. These figures, respectively, were 4.93 crore and Rs. 4257.07 crore in March 2010.

c. Small overdrafts in No-frills accounts: Up to June 2011, banks had provided 9.34 lakh ODs amounting to Rs. 37.42 crore. The figures, respectively were 1.31 lakh and Rs. 8.34 crore in March 2010.

d. General credit cards: Banks have been asked to consider introduction of a general purpose credit card (GCC) facility up to Rs. 25000/- at their rural and semi-urban branches. As on June 2011, banks had provided credit aggregating Rs. 2356.25 crore in 10.70 lakh GCC accounts.

e. Kisan credit cards: As on June 30, 2011 the total number of KCCs issued has been reported as 202.89 lakh with a total amount outstanding to the tune of 1,36,122.32 crore.

Financial inclusion through Mobile Banking

Out of the 6,00,000 habitations in the country, less than 30,000 have a commercial bank branch., only 55% of the population have deposit accounts, and the proportion of people having any kind of life insurance is as low as 10 percent. 52 banks have been approved t commence mobile banking services. The volume of mobile banking transactions in July 2011 was 1.74 million with a value of Rs. 1.51 billion, an increase of 223% over the position in July 2010.

RBI has progressively liberalized the manner and extent to which banks can conduct mobile banking, alive to the needs to the market, in particular, the unbaked population and the migrant labour force within the country. Banks are permitted to facilitate funds transfer between banks accounts through a mobile phone. To enable such transfers in a cost-effective manner particularly for the small ticket transactions, RBI has waived the need for end-to-end encryption for transactions of value up to Rs. 5000 (around US$ 100).

Road ahead: Issues and challenges

a. Appropriate and effective technology key for financial inclusion The Business Correspondent (BC) model may not be commercially viable at the initial stage due to high transaction costs for banks and customers. The need is to develop and implement scalable, platform- independent technology solutions which, when implemented on a large scale, will bring down the high cost of operation.

b. Integrated delivery and business model. Presently, a number of different models involving handheld devices with smart cards, mobiles, mini ATMs, etc are being tried out and it is necessary that they are integrated with the backend core banking solution (CBS) system for scaling up.

c. Opening of brick and mortar branches in unbanked villages. The branches can be low cost intermediary simple structure, supporting up to 8-10 BCs at a reasonable distance of 2-3 kms. This will lead to efficiency in cash management, documentation and redressal of customer grievances, which will also act as an effective supervisory mechanism for BC operations. The BCs, who are the first level of contact for customers, have to compensate adequately so that they too see this as business opportunity.

d. Leveraging ICT solutions- Though the cost of administering small ticket personal transactions is high, these can be brought down if banks effectively leverage ICT solutions supplemented through product innovation with superior cost efficiency. Mobile banking has tremendous potential and the benefits of e-commerce need to be exploited.

e. Availability of adequate infrastructure. It is important that adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, etc. are available.

f. Mindset, cultural and attitudinal changes- At grass roots and cutting edge technology levels of branches of banks are needed to impart organizational resilience and flexibility. Banks should have reward and recognition for personnel initiating, ideating institute systems, innovating and successfully executing new products and services in the rural areas.

Conclusion

Empirical evidence shows that economic growth follows financial inclusion. Our dream of inclusive growth will not be realized until we create millions of micro-entrepreneurs across the country. Inclusive growth will act as source of empowerment and allow people to participate more effectively in the economic and social process. Amartya Sen convincingly argues that poverty is not merely insufficient income rather the absence of wide range of capabilities, including security and ability to participate in economic and political systems. Financial inclusion is designed to bring about the capability to participate and contribute among the economically and socially excluded people by creating equal opportunities.

The Indian experience has proved that financial inclusion can work within the framework of financial stability given an enabling regulatory environment. The twin objectives of financial stability and financial inclusion are arguably two sides of a coin but it is imperative that a robust risk mitigating framework which exploits their complementarities while minimizing the conflicts is adopted to ensure that they do not work at cross purposed.

Financial inclusion is the road which India needs to travel towards becoming a global player. An inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process. Banks that have global ambitions must meet local aspirations. Financial access will also attract global market player to our country that will result in increasing employment and business opportunities. Technology is great enabler and has to act as a ladder, with a human touch, to achieve the ultimate goal of providing financial services to the financially excluded. This requires training the banks frontline staff and managers as well as business correspondents on the human side of banking. The bank should also take care of customer grievances. It may be noted that the “The future lies with those who see the poor as their customers” as commerce for the poor is more viable than the rich.

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