

Financial Inclusion: Offering Banking Services for the Poor

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Abstract-*Financial inclusion is one of the top most policy priorities of the Government of India. Taking cue from the state proclivity towards inclusive growth agenda, the Reserve Bank of India (RBI) has taken a proactive role in ushering the enabling environment for expediting financial inclusion across length and breadth of the country through bank led model. To reach out at 400 million plus under banked population at pace with profitability is the single most important challenge faced by the multistakeholders, particularly banks and delivery channels. Financial inclusion is delivery of banking services at an affordable cost to the vast sections of advantaged and low income groups.*

Keywords: *Financial inclusion, Reserve Bank of India (RBI), Daily wage earners*

Introduction

The genesis of inclusive growth can be traced back to late 1960s when banks were brought under the scheme of social control in the year 1967, followed by nationalization of 14 major commercial banks in 1969. Then in 1970, the Lead Bank Scheme was introduced and each State was assigned to one commercial bank as the Lead Bank to coordinate the efforts of financial institutions in meeting the credit needs of the economy. The social banking agenda of the government led to higher banking penetration through rapid branch expansion, delivery of credit to priority sectors and deposit mobilization in the 1970s and 80s. Between 1969 and 1990, number of bank branches increased by 7 times and share of rural branches in total network increased from 22 per cent to 58 per cent. Similarly, financial savings of the household as percent to total

household savings increased from 25 per cent in 1969 to 46 percent in 1990. The bank nationalization in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. However, large part of the population including farmer households still remains unbanked.

The States like Bihar, Orissa, Rajasthan Uttar Pradesh, Chhattisgarh, Jharkhand, West Bengal and North-Eastern States are under-banked. When compared to the developed world, the coverage of our financial services is quite low. Then the Reserve Bank of India has set up a commission (Khan Commission) in 2004 to look into financial inclusion and the recommendations of the commission were incorporated into the mid-term review of the policy (2005–06). In the report RBI exhorted the banks with a view of achieving greater financial inclusion to make available a basic "no-frills" banking account. In India, Financial Inclusion first featured in 2005, when it was introduced, that, too, from a pilot project in UT of Pondicherry, by K C Chakraborty, the chairman of Indian Bank. Mangalam Village became the first village in India where all households were provided banking facilities. In addition to this KYC (Know your Customer) norms were relaxed for people intending to open accounts with annual deposits of less than Rs. 50,000. General Credit Cards (GCC) were issued to the poor and the disadvantaged with a view to help them access easy credit.

In January 2006, the Reserve Bank permitted commercial banks to make use of the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions and other civil society organizations as

intermediaries for providing financial and banking services. These intermediaries could be used as business facilitators (BF) or business correspondents (BC) by commercial banks. The bank asked the commercial banks in different regions to start a 100% financial inclusion campaign on a pilot basis. As a result of the campaign states or U.T.s like Pondicherry, Himachal Pradesh and Kerala have announced 100% financial inclusion in all their districts. In its platinum jubilee year, the Reserve Bank of India (RBI) wants to connect every Indian to the country's banking system. RBI is currently working on a three-year financial inclusion plan and is discussing this with each bank to see how to take this forward, KC Chakrabarty, deputy governor, RBI said.

"Nearly forty years after nationalization of banks, 60% of the country's population does not have bank accounts and nearly 90% do not get loans," he pointed out. India has currently the second-highest number of financially excluded households in the world. Approximately, 40% of India's population have bank accounts, and only about 10% have any kind of life insurance cover, while a meager 0.6% have non-life insurance cover.

Reserve Bank of India's vision for 2020 is to open nearly 600 million new customers' accounts and service them through a variety of channels by leveraging on IT. However, illiteracy and the low income savings and lack of bank branches in rural areas continue to be a road block to financial inclusion in many states. India, being a mostly agrarian economy, hardly has schemes which lend for agriculture. Along with microfinance we need to focus on Micro insurance too.

Financial Inclusion: Challenges Ahead

Extending banking and credit services in rural and informal urban areas is a daunting challenge, considering the grassroots level realities which are characterized by dilapidated soft and hard infrastructure like intermittent or no broadband and telecom connectivity, irregular power supply, unreliable public transport, sketchy road network, erratic cash

flows among poor household and finally lack of a universally available and readily acceptable common identity proof. Serving low value retail customers in these geographies pose some operational, regulatory and viability challenges for banks. Banks are profit oriented entities and must be able to recover the costs which they incur in providing services like deposits, credit, remittance, insurance etc. Otherwise the model would be unstable and may collapse one day. On regulatory part the Indian central bank does not make any incentivizing exceptions for banks based on branch size, location and business potential for operations like cash management, branch banking services, staffing, operating hours and the most important lending and interest rates on savings, which make banking with poor is an expensive affair for banks. There is a huge banking potential at base of the pyramid but it is required to overcome all of the identified barriers. Any successful model would essentially need to address all the barriers at the same time. This entails change in the approach of delivering services to the unbanked and under-banked areas. Therefore, the need was felt for more innovative, cost effective and easily accessible delivery channel which would take financial services to the nooks and corners of India.

The latest mantra which has potential to solve the extant of financial exclusion in India is the RBI proposed branchless banking model – the business correspondent (B.C) channel. The B.C enables financial inclusion by acting as an agent on behalf of bank. Basically the agent based model of banking beyond branches has emerged in Brazil where banks have been using correspondents since 1970 and it proliferated to other parts of the world like Kenya, South Africa, and Philippines, Mexico etc. in its variants. Based on the domestic realities and global learning, the Public-policy in India ushered a wave of branchless banking on January 25th, 2006 when the RBI came up with the initial guidelines on use of business correspondents by banks with the policy objective of making social exclusion a history through financial inclusion of poor and vulnerable.

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International Experience

Typically, countries with low levels of income inequality tend to have lower levels of financial exclusion, while high levels of exclusion are associated with the least equal ones. In Sweden, for example, lower than two per cent of adults did not have an account in 2000 and in Germany, the figure was around three per cent (Kempson, 2006). In comparison, less than four per cent of adults in Canada and five per cent in Belgium, lacked a bank account (Buckland et al, 2005). Countries with high levels of inequality record higher levels of banking exclusion. To illustrate, in Portugal, about 17 per cent of the adult population had no account of any kind in 2000 (Kempson, 2006).

In Sweden, for example, banks cannot refuse to open a saving or deposit account under Section 2 of the Banking Business Act of 1987; in France, Article 58 of the Banking Act, 1984 recognised the principle of the right to a bank account; in the US, federal government introduced the Community Reinvestment Act in 1997, partly in response to concerns about bank branch closures in low-income neighbourhoods. Under this legislation, federal bank regulatory agencies rate banks on their efforts to serve low-income communities. These early legislations were designed to ensure access to a deposit account but did not spell out the nature of banking services that should be on offer. Refinements in this area have actually taken place in the latter half of the 1990s, resulting partly from a wider concern regarding social exclusion (Caskey et al, 2006, Kempson et al, 2000). It may, thus, be noted that financial inclusion is a concern even in developed countries and legislative or regulatory measure to achieve it are a common feature.

Review of literature

According to Indian institute of banking and finance, "financial inclusion is delivery of banking services at an affordable cost ('no frills' accounts,) to the vast sections of disadvantaged and low income group. Unrestrained access to public goods and

services is the sine qua non of an open and efficient society. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy." According to Dr. K.C. Chakrabarty, Deputy Governor, Reserve Bank of India, 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 mainstream institutional players.

According to V.Leeladhar, Reserve bank of India bulletin, Jan 2006, financial inclusion is delivery of banking services at an affordable cost to the vast sections of advantaged and low income groups. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy.

According to committee of financial inclusion, "The process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream Institutional players."

According to M.K.Samantaray General Manager Reserve Bank of India Guwahati, Large segment of population remaining excluded from formal payments system & financial markets when financial market developing & globalizing – Obvious market failure – Government & financial sector regulators creating enabling conditions for inclusive & affordable market.

Discussions

In Impact of SHGs on Financial Inclusion article, the author discussed about the financial inclusion through curbing the hegemony of

village moneylenders we suggest for implementing the SHG-Bank/Co-operative Linkage more intensively in rural areas.

In Taking Banking Services to the Common Man - Financial Inclusion article, the author focused on large sections of low income groups transactions are related to deposits and withdrawals, with a view to containing transaction costs, 'simple to use' cash dispensing and collecting machines akin to ATMs, with operating instructions and commands in vernacular would greatly facilitate financial inclusion of the semi urban and rural populace.

In Role of Financial Institutions in Financial Inclusion article, the author discussed on lack of financial literacy is the major hindrance in spreading financial inclusion. This has resulted in the more than 50 per cent of savings of the household sector and of the financially illiterate getting drained in non-financial investments. In Financial Inclusion: The Way Forward article, the author discussed about the Bank provides collateral free need based composite loan to this segment directly for acquiring capital assets and also for their working capital/ marketing related requirements. This renewed focus on this segment has the potential for large-scale employment generation through direct Micro Enterprise Loan by SIDBI and selected MFIs.

Conclusion

The financial system in India has grown rapidly in the last three decades and more. The functional and geographical coverage of the system is truly impressive. There is an imperative need to modify the credit and financial services delivery system to achieve greater inclusion. While banks and other financial institutions can also take some efforts on their own to improve the absorptive capacity of the clients, it is equally important for Government at various levels to initiate actions to enhance the earnings capacity of the poorer sections of the society with special reference to daily wage earners where there is more need to create awareness and educate them on these lines.

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