Issues & Challenges in Financial Inclusion: Policies, Partnerships, Processes & Products

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Importance of financial inclusion

* Whether financial inclusion can be interpreted as a public good?
  * conditions of ‘***non-rivalness***’ in consumption and ***non-excludability***
* Entire national financial system benefits by greater inclusion
  * when promoted in the wider context of economic inclusion
  * multiplier effect on the economy through enhanced savings & credit to the people at the bottom of the pyramid
  * banks benefit by stable deposit base contributed by retail customers
  * promotes financial stability and discourages informal sectors
  * facilitates transfer of government benefits without leakages
* Greater participation in the formal financial system makes monetary policy more effective
  * enhances the prospects of non-inflationary growth
  * facilitates move towards less cash society

Indian approach to financial inclusion

- What is financial inclusion?
  - growth and equity
    - Inequalities exist in socio-economic conditions, literacy, income level, urbanization, infrastructure
- Financial inclusion is about ensuring **5A's**

  Adequacy **Availability** **Accessibility**

  Awareness **Affordability**

- Adoption of multi-pronged strategy
  - network of bank branches ,
  - tapping SHGs, MFIs, etc.
  - enhancing network through BCs/BFs & TSPs
  - wide range of banking products.
- Policy approach
  - *Minimalist* – a bouquet of basic banking products & services
  - *Expanded* - ancillary financial products like insurance, pension, deeper customer engagement, consumer protection and enhanced financial literacy

India's position compared with other countries

Country	Number of branches	Number of ATMs	Bank credit	Bank deposits
	(per 0.1 million adults)		(as per cent of GDP)	
India	10.91	5.44	43.62*	60.11*
Austria*	11.81	48.16	35.26	32.57
Brazil	13.76	120.62	29.04	47.51
France	43.11	110.07	56.03	39.15
Mexico	15.22	47.28	16.19	20.91
UK*	25.51	64.58	467.97	427.49
US	35.74	173.75*	46.04	53.14
Korea	18.63	250.29*	84.17	74.51
Philippines	7.69	14.88	27.57	53.02

Source: *World Bank, Financial Access Survey*

Note: *Data pertains to 2010. For rows/cells indicated as '*' data pertains to 2009.*

Progress of Financial Inclusion Plan

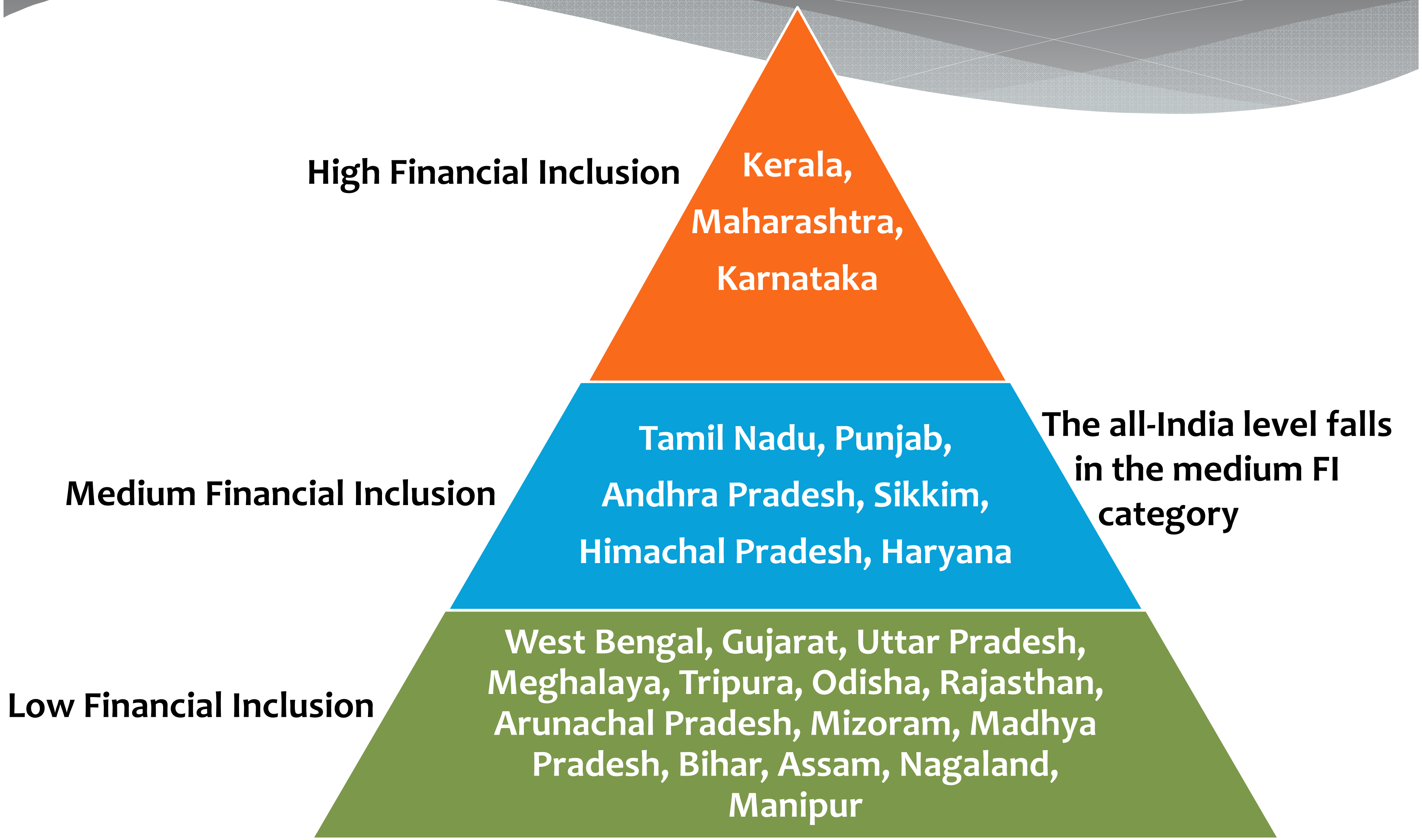
(as on March 31, 2012)

Banking outlets Rural branches BC outlets Other modes Total	 24,701 1,20,355 2,478 1,47,534
Total number of 'No frill accounts'	103.21 million (increase of 39.6%)
Operations in NFA (2011-12) Outstanding balance Overdrafts	 Rs. 932.89 billion Rs. 3.39 billion
Transactions through ICT based BC outlets (2011-12) KCC credit GCC credit	119.77 million Rs. 2.15 million Rs. 0.22 million

Measuring Financial Inclusion

* Three basic dimensions of an inclusive financial system
  * **Banking penetration**
    * size of the banked population, i.e., number of adult population having a bank account
      * number of bank accounts as a proportion of the total population
  * **Availability of the banking services**
    * number of bank outlets & ATMs (per 1000 population)
      * number of bank branches per 1000 adult population and also number of branches per square km
  * **Usage of the banking system**
    * merely having a bank account does not ensure that the system is inclusive; adequate utilization is imperative
      * volume of outstanding deposit and credit as proportion of the Net District Domestic Product

State-wise Index of financial Inclusion



(Source: RBI Working Paper on Financial Inclusion in India : A case-study of West Bengal by Sadhan Kumar Chattopadhyay)

Need to focus on Policies, Partnership, Processes & Products relating to

* SHGs
* MFIs
* Business Correspondents
* Technology

for meaningful financial inclusion

SHG Bank Linkage Programme

* **'Savings-first, credit later'** model
  * credit discipline 'social collateral' made SHGs bankable.
* For banks dealing with groups of people meant
  * reducing in transaction costs,
  * reducing the credit risks through 'peer pressure' and
  * making people save
* Challenges
  * inadequate outreach in many regions, delays in opening of SHG accounts and disbursement of loans, impounding of savings by banks as collateral

SHG-2

* More **focus on voluntary savings**
* Cash credit system of lending over **3 to 5 years cycle**
    * to minimize the problem of inadequate finance and non-availability of repeat loans
* Enabling creation of Joint Liability Groups (JLGs) within SHGs
    * to scale up economic activities by more entrepreneurial members
* Improving **risk mitigation systems** by bringing in **third party audit**
* Building second tier institutions
* Strengthening the monitoring mechanism
* Addressing training requirements

Micro Finance Institutions (MFIs)

* Graduated from an "experiment" to a well-accepted paradigm of rural and developmental financing in India.
* MFIs have served the underserved/un-served populace and improved access to credit
  * debate on their style of corporate governance and ethics of conducting business
* To sustain existence, business and credibility, MFIs must
  * revisit their business model –profitability vs. profiteering
  * re-engineer the customer responsive processes
  * revisit business strategy
  * reinvent the sector as a community relevant to public and policy support

Business Correspondents

- Recommendations of the Internal Group to examine issues relating to rural credit and microfinance
  - Business Facilitators (BFs) and Business Correspondents (BCs) for ensuring door step delivery of financial products and services
- **Expansion of BC universe**
  - Owned by corporates
  - Owned by banks
- **Ultra-small centres of banks**
  - simple brick & mortar structure located between base branch and BC locations
  - terminal linked to CBS and a pass book printer
- **Interoperability of BCs**
  - a customer can approach any BC
  - allow BCs of one bank to service customers of other banks
  - transactions and authentications are carried out online on CBS platform

Issues & challenges

- Viability of the model
  - need for more products and more innovations
- Remuneration of BCs
- Technology related issues
- Banks exposed to multiple risks
  - credit risk, operational risk, legal risk, liquidity risk and reputational risk
- Mis-selling of financial products to uninformed & illiterate consumers
- Conflict of interest in case of corporate BCs
- Difficulty in replacing the BCs
- Cash management
  - people not willing to deposit huge amounts with the BCs

Possible solutions

* Deeper engagement of banks
  * at the corporate and the local levels
* Hand-holding by banks by way of orientation/training
* Expanding the BC network
  * cluster approach (?)
* Redesigning existing/introduction of innovative products
  * No Frill Accounts (NFA) replaced by Basic Bank Account
  * Micro-insurance products bundled with savings/credit products
* Appropriate financial literacy initiatives
* Awareness about customer grievance redressal mechanism

Tapping technology platform

- Key to providing models for efficient delivery of small value transactions in large volumes
  - while reaping economies of scale.
- Helps in spreading financial literacy
  - both as a delivery channel and as an intrinsic part of the learning process
- Various platform to choose from
  - Smart cards, micro-ATMs, ATMs
  - Mobile technology
  - Aadhar Enabled Payment Systems (AEPS)

Tapping technology platform

- Experimentation with mobile based remittance services for reaching the unbanked population
  - M-Pesa (Kenya), Tigo Cash (Paraguay), Pago Movi (Peru), Nipper (Mexico), (Oi) Brazil
    - deployment of technology to service low income, financially excluded households

- **Common thread**
    - most schemes use mobile phones
    - others use point-of-sale devices in conjunction with magnetic stripe cards (mostly in Latin America),
    - some use both mobile phones and point-of-sale devices (WIZZIT in South Africa and Smart in the Philippines).

Mobile banking

* Defined as undertaking banking transactions **using mobile phones** by bank customers that involve credit/debit to their accounts
* Rapid growth in the number of mobile phone subscribers in India
  * banks in collaboration with telecom companies have developed an alternate channel of delivery of banking services
* Value and volume are increasing
  * growth rate is low when compared with the mobile subscriber base
    * banks are yet to fully exploit this technology
* Tapping the potential for financial inclusion
  * bank-led mobile banking model for achieving financial inclusion

Mobile banking

* Mobile Network Operator (MNO) based approach
  * Limitations and concerns (e.g. Safricom)
* Banks & MNOs collaborative relationship is preferable
  * Reserve Bank has provided the policy framework
* Plausible reasons for low levels of collaboration
  * ownership of the customer, control of transactions and developing an appropriate revenue sharing model
* Expectations from banks and mobile operators
  * arrive at appropriate decisions while protecting their mutual interests
  * a “win win” situation for both and serve the larger public good of financial inclusion

Inter-bank Mobile Payment Service (IMPS)

* Instantaneous 24x7 electronic funds transfer system
* Reasons for low volume of transactions
  * telecom companies prefer negotiating with individual banks on the issue rather than providing Unstructured Supplementary Service data (USSD) platform
* The USSD platform is menu driven and can be invoked by dialing a number.
  * users with low-cost handsets can perform their banking transactions through the mobiles (not necessarily smartphones)

Measures to encourage m-banking

* Cap of ₹ 50,000/- for mobile banking transactions removed
  * banks to put in place caps based on their risk perceptions.
* Domestic Money Transfer Scheme
  * transfer of funds among domestic debit/credit/pre-paid cards up to ₹ 10,000 with a monthly cap of ₹ 25,000/-
  * balances on mobile wallets can be transferred to other mobile wallets offered by the same company
    * balances can also be transferred to the bank account of the beneficiary from which cash can be withdrawn

Aadhar Enabled Payment Systems (AEPS)

* Basic premise of AEPS
  * one BC Customer Service Point will have the ability to service customers of many banks.
* Empowers a bank customer to use Aadhaar as his/her identity to
  * access the respective Aadhaar enabled bank account and
  * perform basic banking transactions like balance enquiry, cash withdrawal and deposit through a BC
* Pilot scheme in 4 districts of Jharkhand state
  * MGNREGA wages to labourers credited to their Adhaar enabled accounts
  * beneficiaries withdraw the amounts through Micro ATMs which authenticate their Aadhaar number

Challenges in using technology

* Major constraint has been the technology itself
  * Non-functional hand-held machines, smart cards, network connectivity and availability of power
* Limited number of technology service providers to cover the unbanked villages of all banks
* Limited service centres for servicing these devices has resulted in banking operations coming to a halt in many villages
* **Leading to an erosion of confidence on the ICT-based BC model**

Challenges in using technology

* Adequate attention to security features
  * preventing fraud through robust security measures but not losing sight at ease and efficiency in operations
  * ensuring proper balance between assurance and accessibility
* Measures taken by Reserve Bank of India
  * Second Factor Authentication
    * exists for Card Not Present (CNP) transactions
    * in the offing for the Card Present (CP) transaction – chip & pin or Aadhar
  * encryption of mobile based transactions for value above ₹5,000/-

Challenges in using technology

- **Infrastructural limitation**
  - poor internet connectivity slows the pace of banking transactions
- **Technology challenges for smaller banks** like RRBs/Co-op Banks
  - CBS linkages through sponsor banks
  - NABARD lending a helping hand
    - Financial Inclusion Technology Fund
  - Contribution of NPCI e.g. *Ru Pay*
- **Satellite Connectivity Scheme for the NE States**
  - Reserve Bank offers subsidy to branches in the NE states offering services of electronic funds transfer *free of charge* to their customers

Challenges in using technology

* **Banks require partnership and collaboration with other stakeholders**
  * standardization and inter-operability
  * technology service providers, mobile network operators, corporate houses and BCs
* **For significant investment in**
  * technology applications
  * R&D efforts
  * monitoring and evaluation system
* **To develop delivery models**
  * one private sector bank has approved a mobile service provider to act as its BC and provide services to the unbanked

Way forward

* Banks & Technology Service Providers (TSPs) need to develop new product lines
  * rather than merely adopting complex products of urban India
    * Mobile POS, micro-ATMs, Pre-paid instruments, mobile enabled KCC, variable instalment RD, gold linked products, micro-pension, etc.
  * provide simple and basic banking services
  * requires easy-to-understand documentation process
  * Move from assisted to self-service model in a calibrated manner
* More focus on innovative ideas to enhance the staying power of the poor

Way forward

* Policy objective of inclusive growth with financial stability *cannot be achieved without* ensuring universal financial inclusion
* Requires collaboration between across governments, regulators, industry associations and other stakeholders
* Coordinated national strategy is needed for success of the financial inclusion initiatives
* Spreading awareness about
  * financial inclusion
    * tap innovative dissemination channels
    * training the grass-root level staff of banks/BCs/TSPs
  * financial technology
    * **e-BAAT** – *Electronic Banking Awareness And Training*

Way forward

For evolving an effective financial inclusion delivery model

- Customer service needs equal attention
  - dissemination of information to customers
  - developing mechanisms for redressing grievances

- Risk management through prudential regulations
- Responsible financial innovation

- Creation of a facilitating eco-system
  - leveraging on technology and combination of branches, ICT based BC outlets and payment system infrastructure

- Mindset, cultural and attitudinal changes at the grassroots

Way forward

* The Payments System Vision
  * *ensuring that "payment and settlement systems in the country are safe, efficient, interoperable, authorised, accessible, inclusive and compliant with international standards".*

Highlights

* Efficiency enhancement in the payment systems
* Standardisation, portability and inter-operability
* Development of infrastructure and integrated payment system
* Promote access and inclusion
* Innovation and new product developments
* Move towards a less-cash society
* Payment system literacy and visibility

Concluding thoughts

* Sound & strong institutions can deliver financial inclusion
* Leveraging technology service providers
  * Mobile network owners forging partnerships with banks
* Prudent measures
  * Restricting deposit taking to banks
  * NBFCs encouraged to focus on innovative approaches to lending
* Bankability of the poor holds a major business opportunity
  * develops a stable retail deposit base
  * curbs volatility with a diversified asset portfolio
  * expands the scope for sale of third party products (e.g. micro-insurance, pension, mutual funds, etc.)

Concluding thoughts

* Financial inclusion has to be a subset of wider economic inclusion
  * important to generate revenue for economic inclusion for sustainable inclusion
  * financial inclusion would be possible if there is a felt need for financial services
  * banks need to have both model and motivation to convert this to sustainable business opportunities

Financial inclusion is about viable and sustainable business models with focus on accessible and affordable <u>products</u> and <u>processes</u>, synergistic <u>partnerships</u> with technology service providers for efficient handling of low value, large volume transactions and appropriate regulatory and risk management <u>policies</u> that ensure financial inclusion and financial stability move in tandem.

In all our efforts towards financial inclusion we should not forget …

"Financial inclusion is not about giving handouts to anyone, it's about getting the people to help themselves"

Barry Whiteside

Thank you