Financial Inclusion: A Road India Needs to Travel*

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 costs, 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.

It is now well-understood that commerce with the poor is more viable and profitable, provided there is ability to do business with them. The provision of uncomplicated, small, affordable products can help bring low-income families into the formal financial sector. Taking into account their seasonal inflow of income from agricultural operations, migration from one place to another, and seasonal and irregular work availability and income, the existing financial system needs to be designed to suit their requirements. Mainstream financial institutions such as banks have an important role to play in this effort, not as a social obligation, but as a pure business proposition.

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Appropriate Financial Products

Financial inclusion is 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. Financial inclusion has become one of the most critical aspects in the context of inclusive growth and development.

The importance of an inclusive financial system is widely recognised in policy circles and has become a policy priority in many countries. Several countries across the globe now look at financial inclusion as the means to more comprehensive growth, wherein each citizen of the country is able to use earnings as a financial resource that can be put to work to improve future financial status and adding to the nation's progress.

Initiatives for financial inclusion have come from financial regulators, governments and the banking industry. The banking sector has taken a lead role in promoting financial inclusion. Legislative measures have been initiated in some countries. For example, in the US, the Community Reinvestment Act (1997) requires banks to offer credit throughout their entire area of operation and prohibits them from targeting only the rich neighbourhoods. In France, the law on exclusion (1998) emphasises an individual's right to have a bank account.

The German Bankers' Association introduced a voluntary code in 1996 providing for a so-called 'everyman' current banking account that facilitates basic banking 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. In the UK, a Financial Inclusion Task Force was constituted by the government in 2005 in order to monitor the development of the process.

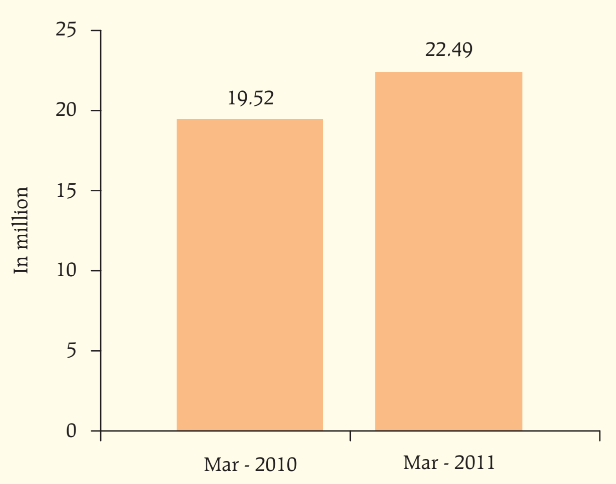
Several African countries have harnessed the unique aspects of mobile banking to drive financial inclusion. A G-20 (Group of Twenty) Financial Inclusion Experts Group has been launched. The Principles for Innovative Financial Inclusion serve as a guide for policy and regulatory approaches with the objectives of fostering safe and sound adoption of innovative, adequate, low-cost financial delivery models, helping provide conditions for fair competition and a framework of incentives for the various banking, insurance, and non-banking entities involved and delivery of the full range of affordable and quality financial services.

Broader Financial Inclusion

India has, for a long time, recognised the social and economic imperatives for broader financial inclusion and has made an enormous contribution to economic development by finding innovative ways to empower the poor. Starting with the nationalisation of banks, priority sector lending requirements for banks, lead bank scheme, establishment of regional rural banks (RRBs), service area approach, self-help group-bank linkage programme, *etc.*, multiple steps have been taken by the Reserve Bank over the years to increase access to the poorer segments of society.

It encouraged expansion of bank branches, especially in rural areas, resulting in multifold increase in branch network from around 8,000 in 1969 to more than 89,000 today, spread across the length and breadth of the country. The accompanying chart and graph show population group-wise distribution of bank branches of scheduled commercial banks, including RRBs, over all these years.

Chart 2: Kisan Credit Cards



Branches of Scheduled Commercial Banks

Despite all these efforts, a significant proportion of the households, especially in rural areas, still remained outside the coverage of the formal banking system. It is estimated that about 40 per cent of Indians lack access even to the simplest kind of formal financial services.

Chart 1: General Credit Cards

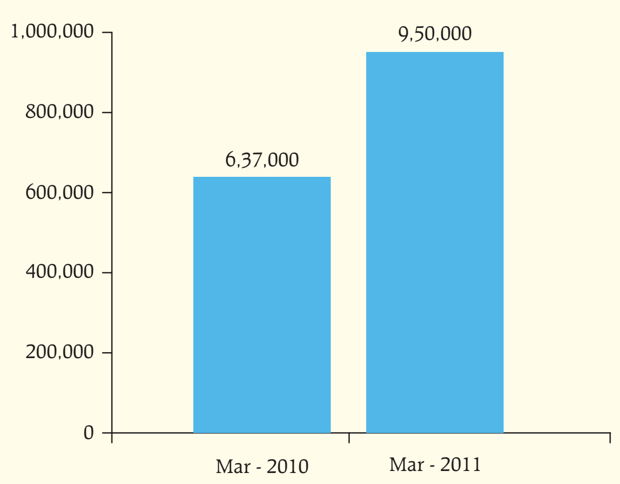
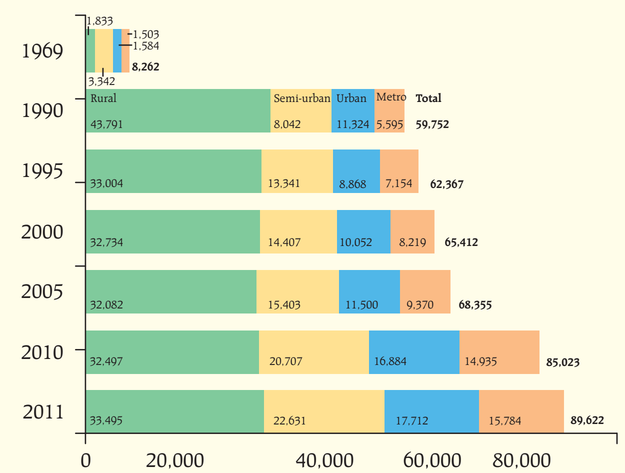


Chart 3: Branches of Scheduled Commercial Banks*



*Including regional rural banks

The major barriers to serve the poor, apart from socioeconomic factors such as lack of regular income, poverty, illiteracy, *etc.*, are the lack of reach, higher cost of transactions and time taken in providing those services. Products designed by the banks are not tailored to suit the needs of low-income families. The existing business models do not pass the test of scalability, convenience, reliability, flexibility and continuity.

In India, the term financial inclusion first featured in 2005, when the Reserve Bank, in its annual policy statement of 2005-06, while recognising the concerns in regard to the banking practices that tend to exclude rather than attract vast sections of the population, urged banks to review their existing practices to align them with the objective of financial inclusion.

National Commitment

Moving towards universal financial inclusion has been both a national commitment as well as a public policy priority for our country. To achieve the ultimate objective of reaching banking services to all the 6,00,000 villages, financial inclusion has to become a viable business proposition for the banks.

For this to happen, the delivery model needs to be devised carefully so as to move from a cost-centric model to a revenue-generation model. This will help in providing customers with quality banking services at their doorstep and at the same time generating business opportunities for the banks. This is sustainable only if delivery of banking services, at the minimum, includes the following four products:

- A savings-cum-overdraft account
- A remittance product for electronic benefit transfer (EBT) and other remittances
- A pure savings product, ideally a recurring deposit scheme
- Entrepreneurial credit in the form of a kisan credit card (KCC) or a general credit card (GCC)

Chart 4: Villages Covered

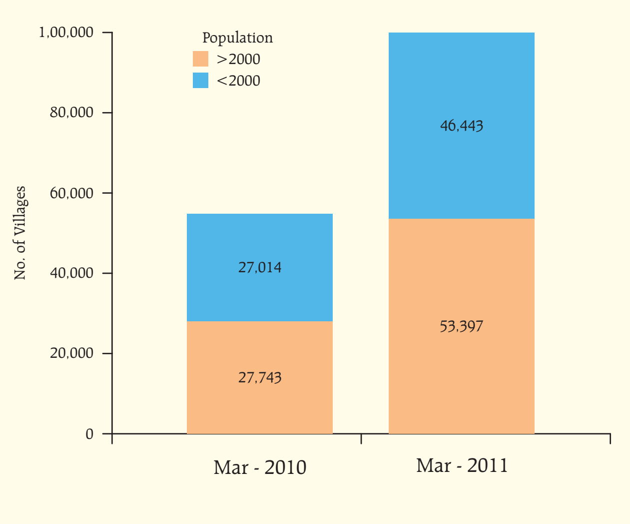
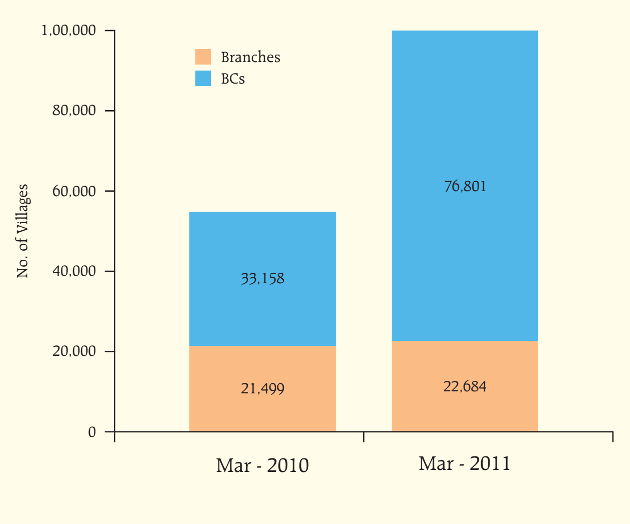


Chart 5: Branches Vs Business Correspondents



The Reserve Bank has been undertaking financial inclusion initiatives in a mission mode through a combination of strategies ranging from provision of new products, relaxation of regulatory guidelines and other supportive measures to achieve sustainable and scalable financial inclusion.

In India, The Reserve Bank has initiated several measures to achieve greater financial inclusion, such as facilitating no-frills accounts and GCCs for small deposits and credit. Some of these steps are:

Opening of no-frills accounts: Basic banking no-frills accounts with nil or very low minimum balance as well as charges that make such accounts accessible to vast sections of the population. Banks have been advised to provide small overdrafts in such accounts.

Relaxation on know-your-customer (KYC) norms: KYC requirements for opening bank accounts were relaxed for small accounts in August 2005, thereby simplifying procedures by stipulating that introduction by an account holder who has been subjected to the full KYC drill would suffice for opening such accounts.

The banks were also permitted to take any evidence as to the identity and address of the customer to their satisfaction. It has now been further relaxed to include the letters issued by the Unique Identification Authority of India containing details of name, address and Aadhaar number.

Engaging business correspondents (BCs): In January 2006, the Reserve Bank permitted banks to engage business facilitators (BFs) and BCs as intermediaries for providing financial and banking services. The BC model allows banks to provide doorstep delivery of services, especially cash-in-cash-out transactions, thus addressing the last-mile problem. The list of eligible individuals and entities that can be engaged as BCs is being widened from time to time. With effect from September 2010, for-profit companies have also been allowed to be engaged as BCs.

Use of technology: Recognising that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas in a viable manner, banks have been advised to make effective use of information and communications technology (ICT), to provide doorstep banking services through the BC model where the accounts can be operated by even illiterate customers by using biometrics, thus ensuring the security of transactions and enhancing confidence in the banking system.

Adoption of EBT: Banks have been advised to implement EBT by leveraging ICT-based banking through BCs to transfer social benefits electronically to the bank account of the beneficiary and deliver government benefits to the doorstep of the beneficiary, thus reducing dependence on cash and lowering transaction costs.

General Credit Cards: With a view to helping the poor and the disadvantaged with access to easy credit, banks have been asked to consider introduction of a general purpose credit card facility up to ₹25,000 at their rural and semi-urban branches. The objective of the scheme is to provide hassle-free credit to banks' customers based on the assessment of cash flow without insistence on security, purpose or end-use of the credit. This is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned.

Simplified branch authorisation: To address the issue of uneven spread of bank branches, in December 2009, domestic scheduled commercial banks were permitted to freely open branches in tier III to tier VI centres with a population of less than 50,000 under general permission, subject to reporting. In the north-eastern states and Sikkim, domestic scheduled commercial banks can now open branches in rural, semi-urban and urban centres without the need to take permission from the Reserve Bank in each case, subject to reporting.

Opening of branches in unbanked rural centres: To further step up the opening of branches in rural areas so as to improve banking penetration and financial inclusion rapidly, the need for the opening of more bricks-and-mortar branches, besides the use of BCs, was felt. Accordingly, banks have been mandated in the April monetary policy statement to allocate at least 25 per cent of the total number of branches to be opened during a year to unbanked rural centres.

Road-map for providing banking services in unbanked villages with a population of more than 2,000: Banks were advised to draw up a road-map to provide banking services in every unbanked village having a population of over 2,000 by March 2012. The Reserve Bank advised banks that such banking services need not necessarily be extended through a brick-and-mortar branch, but could also be provided through any of the various forms of ICT-based models. About 73,000 such unbanked villages were identified and allotted to various banks through state-level bankers' committees.

Financial inclusion plans of banks for three years: The Reserve Bank advised all public and private sector banks to submit a board-approved, three-year financial inclusion plan (FIP) starting April 2010. These plans broadly include self-set targets in respect of rural brick-and-mortar branches opened; BCs employed; coverage of unbanked villages with a population above 2,000 as also other unbanked villages with population below 2,000 through branches; BCs and other modes; no-frills accounts opened, including through BC-ICT; KCCs and GCCs issued; and other specific products designed by them to cater to the financially excluded segments.

Banks were advised to integrate board-approved FIPs with their business plans and to include the criteria on financial inclusion as a parameter in the performance evaluation of their staff. The progress by commercial banks (excluding RRBs) during the year 2010-11 clearly indicates that banks are on the right path towards deploying BCs, villages covered, opening of no-frills accounts, and grant of credit through KCCs and GCCs. The numbers would be much higher if the figures pertaining to RRBs were to be added.

Long Way to Go

As indicated above, while India has made enormous strides towards greater financial inclusion, there is a long way to go, about 5,00,000 villages are yet to be provided with banking services. The financial inclusion for the underprivileged will lead to hosts of downstream opportunities with an estimated 5,00,000 jobs for the participants to work as BCs at remote villages.

In a networked India in which banking services are extended to all villages, ultimately, a so-called model will emerge where customers will have the option to transact with the bank of their choice in any village by using UID (unique identity)-enabled micro-ATMs (automated teller machines), reducing the dependence on cash and lowering transaction costs. The task is gigantic, but definitely achievable by following a systematic approach:

- Awareness in general, coupled with financial awareness on opening and operating accounts, must accompany the financial inclusion initiative.
- Banks should prepare comprehensive plans to cover all villages, through a mix of branchless banking and brick-and-mortar branch banking. They should speed up enrolment of customers and opening of UID-enabled bank accounts. It envisages putting in place a system that enables routing of all social benefits to bank accounts electronically as also seamless cash transfer to the poor, as and when the government replaces the age-old system of subsidy and public distribution system with cash transfers.

The success of the BC model is highly dependent on the kind of support provided by base branches, especially for cash management, documentation and redressal of customer grievances. Hence, it is necessary that a brick-and-mortar structure is available to support about 8-10 BCs at a reasonable distance of 2-3 k.m. These branches can be low-cost intermediary simple structures comprising minimum infrastructure for operating small customer transactions and can act as an effective supervisory mechanism for BC operations.

- As mentioned earlier, banks must provide minimum four products — a no-frills savings account with an overdraft facility, a pure savings product, entrepreneurial credit and remittance services, and new products tailored to income streams of poor borrowers and according to their needs and interests. Banks must be able to offer the entire suite of financial products and services to poor clients at attractive pricing.

Though the cost of administering small-ticket personal transactions is high, this can be brought down if banks effectively leverage ICT solutions. This can be attained through product innovation with superior cost efficiency. They must understand and penetrate the rural markets efficiently to cross-sell products and services. Mobile banking has tremendous potential and the benefits of m-commerce need to be exploited.

- It is important that adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, *etc.*, is available. All stakeholders will have to work together through sound and purposeful collaborations. Local and national-level organisations have to ensure that these partnerships look at both commercial and social aspects to help achieve scale, sustainability and impact.

This collaborative model will have to tackle exclusion by stimulating demand for appropriate financial products, services and advice with the appropriate delivery mechanism, and by ensuring that there is a supply of appropriate and affordable services available to those that need them.

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

Conclusion

Empirical evidence shows that economic growth follows financial inclusion. Boosting business opportunities will definitely increase the gross domestic product, which will be reflected in our national income growth. People will have safe savings along with access to allied products and services such as insurance cover, entrepreneurial loans, payment and settlement facility, *etc.*

Our dream of inclusive growth will not be complete until we create millions of micro-entrepreneurs across the country. All budding entrepreneurs have to face these challenges and find solutions. People working in the social sector should work for filling up the deficit existing in the economic and social arena.

To sum up, financial inclusion is the road that India needs to travel toward becoming a global player. Financial access will attract global market players to our country and that will result in increasing employment and business opportunities. Inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process.