

## V Leeladhar: Taking banking services to the common man - financial inclusion

Commemorative lecture by Mr V Leeladhar, Deputy Governor of the Reserve Bank of India, at the Fedbank Hormis Memorial Foundation, Ernakulam, 2 December 2005.

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Ladies and Gentlemen,

I am truly honoured to deliver the Fedbank Hormis Memorial Foundation commemorative lecture. The illustrious list of the previous years' speakers indicates the kind of significance this commemorative lecture has acquired over the years. The late Shri K.P.Hormis, founder of Federal Bank, was a visionary and left behind an institutional set up in the form of Federal Bank which has been doing yeoman service for well over seventy five years. The Fedbank Hormis Memorial Foundation, a public charitable trust, has been furthering the cause of banking and finance by providing knowledge and training in the areas of banking, finance, economics and management to banking professionals as well as deserving students who are specializing in these areas. As the life and times of late Shri K.P.Hormis were spent largely in taking banking to the masses, which is indicated by Federal Bank's mix of urban and rural coverage, I thought it would be appropriate for me to speak on taking banking services to the common man – financial inclusion, a topic of contemporary significance and relevance.

The banking industry has shown tremendous growth in volume and complexity during the last few decades. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are concerns that banks have not been able to include vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services. Internationally also efforts are being made to study the causes of financial exclusion and designing strategies to ensure financial inclusion of the poor and disadvantaged. The reasons may vary from country to country and hence the strategy could also vary but all out efforts are being made as financial inclusion can truly lift the financial condition and standards of life of the poor and the disadvantaged.

### What is financial inclusion?

- Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged 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.

### The scope of financial inclusion

The scope of financial inclusion can be expanded in two ways.

- a) through state-driven intervention by way of statutory enactments (for instance the US example, the Community Reinvestment Act and making it a statutory right to have bank account in France).
- b) through voluntary effort by the banking community itself for evolving various strategies to bring within the ambit of the banking sector the large strata of society.

When bankers do not give the desired attention to certain areas, the regulators have to step in to remedy the situation. This is the reason why the Reserve Bank of India is placing a lot of emphasis on financial inclusion.

In India the focus of the financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account without frills, to all. Internationally, the financial exclusion has been viewed in a much wider perspective. Having a current account / savings account on its own, is not regarded as an accurate indicator of financial inclusion. There could be multiple levels of financial inclusion and exclusion. At one extreme, it is possible to identify the 'super-included', i.e., those customers who are actively and persistently courted by the financial services industry, and who have at their disposal a wide range of financial services and products. At the other extreme, we may have the financially

excluded, who are denied access to even the most basic of financial products. In between are those who use the banking services only for deposits and withdrawals of money. But these persons may have only restricted access to the financial system, and may not enjoy the flexibility of access offered to more affluent customers.

### Consequences of financial exclusion

Consequences of financial exclusion will vary depending on the nature and extent of services denied. It may lead to increased travel requirements, higher incidence of crime, general decline in investment, difficulties in gaining access to credit or getting credit from informal sources at exorbitant rates, and increased unemployment, etc. The small business may suffer due to loss of access to middle class and higher-income consumers, higher cash handling costs, delays in remittances of money. According to certain researches, financial exclusion can lead to social exclusion.

### International experience in promoting financial inclusion

An interesting feature which emerges from the international practice is that the more developed the society is, the greater the thrust on empowerment of the common person and low income groups. It may be worthwhile to have a look at the international experience in tackling the problem of financial exclusion so that we can learn from the international experience.

The Financial Inclusion Task Force in UK has identified three priority areas for the purpose of financial inclusion, viz., access to banking, access to affordable credit and access to free face-to-face money advice. UK has established a Financial Inclusion Fund to promote financial inclusion and assigned responsibility to banks and **credit unions** in removing financial exclusion. Basic bank no frills accounts have been introduced. An enhanced legislative environment for credit unions has been established, accompanied by tighter regulations to ensure greater protection for investors. A **Post Office Card Account (POCA)** has been created for those who are unable or unwilling to access a basic bank account. The concept of a Savings Gateway has been piloted. This offers those on low-income employment £1 from the state for every £1 they invest, up to a maximum of £25 per month. In addition the **Community Finance Learning Initiatives (CFLIs)** were also introduced with a view to promoting basic financial literacy among housing association tenants.

A civil rights law, namely Community Reinvestment Act (CRA) in the United States prohibits discrimination by banks against low and moderate income neighborhoods. The CRA imposes an affirmative and continuing obligations on banks to serve the needs for credit and banking services of all the communities in which they are chartered. In fact, numerous studies conducted by Federal Reserve and Harvard University demonstrated that CRA lending is a win-win proposition and profitable to banks. In this context, it is also interesting to know the other initiative taken by a state in the United States. Apart from the CRA experiment, armed with the sanction of Banking Law, the State of New York Banking Department, with the objective of making available the low cost banking services to consumers, made mandatory that each banking institution shall offer *basic banking account* and in case of credit unions the *basic share draft account*, which is in the nature of low cost account with minimum facilities. Some key features of the basic banking account are worth-mentioning here.

- the initial deposit amount required to open the account shall not exceed US \$ 25
- the minimum balance, including any average balance, required to maintain such account shall not exceed US \$ 0.10
- the charge for periodic cycle for the maintenance of such accounts to be declared up front
- the minimum number of withdrawal transactions which may be made during any periodic cycle at no charge to the account holder must at least be eight
- a withdrawal shall be deemed to be made when recorded on the books of the account holder's banking institution
- except, as provided below, an account holder shall not be restricted as to the number of deposits which may be made to the account without incurring any additional charge
- the banking institution may charge account holders for transactions at electronic facilities which are not operated by the account holder's banking institution as well as other fees

and charges for specific banking services which are not covered under the basic banking account scheme

- every periodic statement issued for the basic banking account should invariably cover on it or by way of separate communiqué maximum number of withdrawals permitted during each periodic cycle without additional charge and the consequences of exceeding such maximum and the fee if any, for the use of electronic facilities which are not operated by the account holder's banking institution.

An interesting feature of basic banking account scheme is the element of transparency i.e. the banking institution should, prior to opening the account, furnish a written disclosure to the account holder describing the main features of the scheme i.e. the initial deposit amount required to open the account, minimum balance to be maintained, charge per periodic cycle for use of such account, maximum number of withdrawal transactions without any additional charge and other charges imposed on transactions for availing electronic facility not operated by the account holder's banking institution, etc.

#### Coverage of Banking Services (Ratio of Demand Deposit Accounts to the adult population)

Region/State/Union Territory	Current Accounts	Savings Accounts	Total Population	Adult Population (Above 19 years)	Total No. Of accounts	No. of acc. Per 100 of population	No. of acc. Per 100 of adult pop.
<b>NORTHERN REGION</b>	<b>4215701</b>	<b>52416125</b>	<b>132676462</b>	<b>67822312</b>	<b>56631826</b>	<b>43</b>	<b>84</b>
Haryana	572660	8031472	21082989	11308025	8604132	41	76
Himachal Pradesh	134285	2433595	6077248	3566886	2567880	42	72
Jammu & Kashmir	277529	3094790	10069917	5379594	3372319	33	63
Punjab	1156137	13742201	24289296	14185190	14898338	61	105
Rajasthan	689657	12139302	56473122	28473743	12828959	23	45
Chandigarh	80607	1126696	900914	546171	1207303	134	221
Delhi	1304826	11848069	13782976	7929589	13152895	95	166
<b>NORTH-EASTERN REGION</b>	<b>476603</b>	<b>6891081</b>	<b>38495089</b>	<b>19708982</b>	<b>7367684</b>	<b>19</b>	<b>37</b>
Arunachal Pradesh	10538	209073	1091117	544582	219611	20	40
Assam	378729	5071058	26638407	14074393	5449787	20	39
Manipur	12514	200593	2388634	1222107	213107	9	17
Meghalaya	24305	458779	2306069	1088165	483084	21	44
Mizoram	3441	117885	891058	476205	121326	14	25
Nagaland	13819	195452	1988636	995523	209271	11	21
Tripura	33257	638241	3191168	1784212	671498	21	38
<b>EASTERN REGION</b>	<b>1814219</b>	<b>47876140</b>	<b>227613073</b>	<b>122136133</b>	<b>49690359</b>	<b>22</b>	<b>41</b>
Bihar	464511	13225242	82878796	40934170	13689753	17	33
Jharkhand	166007	5834341	26909428	13737485	6000348	22	44
Orissa	228160	7030004	36706920	21065404	7258164	20	34
Sikkim	4097	125365	540493	288500	129462	24	45
West Bengal	942733	21544753	80221171	45896914	22487486	28	49
Andaman & Nicobar Islands	8711	116435	356265	213660	125146	35	59
<b>CENTRAL REGION</b>	<b>2202217</b>	<b>64254189</b>	<b>255713495</b>	<b>129316677</b>	<b>66456406</b>	<b>26</b>	<b>51</b>
Chhattisgarh	192067	3346898	20795956	11209425	3538965	17	32
Madhya Pradesh	553381	11731918	60385118	31404990	12285299	20	39
Uttar Pradesh	1324509	45804350	166052859	82229748	47128859	28	57
Uttaranchal	132260	3371023	8479562	4472514	3503283	41	78
<b>WESTERN REGION</b>	<b>3178102</b>	<b>49525101</b>	<b>149071747</b>	<b>86182206</b>	<b>52703203</b>	<b>35</b>	<b>61</b>
Goa	81551	1584177	1343998	891411	1665728	124	187

Gujarat	955964	16220262	50596992	28863095	17176226	34	60
Maharashtra	2127240	31568184	96752247	56207604	33695424	35	60
Dadra & Nagar Haveli	6076	69308	220451	122765	75384	34	61
Daman & Diu	7271	83170	158059	97331	90441	57	93
<b>SOUTHERN REGION</b>	<b>4666014</b>	<b>83386898</b>	<b>223445381</b>	<b>135574225</b>	<b>88052912</b>	<b>39</b>	<b>65</b>
Andhra Pradesh	1156405	23974580	75727541	44231918	25130985	33	57
Karnataka	1086662	19147819	52733958	30623289	20234481	38	66
Kerala	600065	17669723	31838619	20560323	18269788	57	89
Tamil Nadu	1786514	22052812	62110839	39511038	23839326	38	60
Lakshadweep	491	22997	60595	33686	23488	39	70
Pondicherry	35877	518967	973829	613971	554844	57	90
<b>ALL-INDIA</b>	<b>16552856</b>	<b>304349534</b>	<b>1027015247</b>	<b>541031553</b>	<b>320902390</b>	<b>31</b>	<b>59</b>

### Indian scenario

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. The rationale for creating Regional Rural Banks was also to take the banking services to poor people. The branches of commercial banks and the RRBs have increased from 8321 in the year 1969 to 68,282 branches as at the end of March 2005. The average population per branch office has decreased from 64,000 to 16,000 during the same period. However, there are certain under-banked states such as Bihar, Orissa, Rajasthan, Uttar Pradesh, Chattisgarh, Jharkhand, West Bengal and a large number of North-Eastern states, where the average population per branch office continues to be quite high compared to the national average. As you would be aware, the new branch authorization policy of Reserve Bank encourages banks to open branches in these under banked states and the under banked areas in other states. The new policy also places a lot of emphasis on the efforts made by the Bank to achieve, inter alia, financial inclusion and other policy objectives.

One of the benchmarks employed to assess the degree of reach of financial services to the population of the country, is the quantum of deposit accounts (current and savings) held as a ratio to the adult population. In the Indian context, taking into account the Census of 2001 (ignoring the incremental growth of population thereafter), the ratio of deposit accounts (data available as on March 31, 2004) to the total adult population was only 59% (details furnished in the table). Within the country, there is a wide variation across states. For instance, the ratio for the state of Kerala is as high as 89% while Bihar is marked by a low coverage of 33%. In the North Eastern States like Nagaland and Manipur, the coverage was a meager 21% and 27%, respectively. The Northern Region, comprising the states of Haryana, Chandigarh and Delhi, has a high coverage ratio of 84%. Compared to the developed world, the coverage of our financial services is quite low. For instance, as per a recent survey commissioned by British Bankers' Association, 92 to 94% of the population of UK has either current or savings bank account.

### Steps towards financial inclusion

In the context of initiatives taken for extending banking services to the small man, the mode of financial sector development until 1980's was characterized by

- a hugely expanded bank branch and cooperative network and new organizational forms like RRBs;
- a greater focus on credit rather than other financial services like savings and insurance, although the banks and cooperatives did provide deposit facilities;
- lending targets directed at a range of 'priority sectors' such as agriculture, weaker sections of the population, etc;
- interest rate ceilings;
- significant government subsidies channeled through the banks and cooperatives, as well as through related government programmes;

- a dominant perspective that finance for rural and poor people was a social obligation and not a potential business opportunity.

It is absolutely beyond any doubt that the financial access to masses has significantly improved in the last three and a half decades. But the basic question is, has that been good enough. As I mentioned earlier, the quantum of deposit accounts (current and savings) held as a ratio to the adult population has not been uniformly encouraging. There is a tremendous scope for financial coverage if we have to improve the standards of life of those deprived people.

With a view to enhancing the financial inclusion, as a proactive measure, the RBI in its Annual Policy Statement for the year 2005-06, while recognizing the concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, urged banks to review their existing practices to align them with the objective of financial inclusion. In the Mid Term Review of the Policy (2005-06), RBI exhorted the banks, with a view to achieving greater financial inclusion, to make available a *basic banking* 'no frills' account either with nil or very minimum balances as well as charges that would make such accounts accessible to vast sections of the population. The nature and number of transactions in such accounts would be restricted and made known to customers in advance in a transparent manner. All banks are urged to give wide publicity to the facility of such no frills account so as to ensure greater financial inclusion.

Further, in order to ensure that persons belonging to low income group both in urban and rural areas do not face difficulty in opening the bank accounts due to the procedural hassles, the KYC procedure for opening accounts has been simplified for those persons who intend to keep balances not exceeding rupees fifty thousand (Rs. 50,000/-) in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed rupees one lakh (Rs.1,00,000/-) in a year.

### **The way forward**

The banks should come out of inhibited feeling that very aggressive competition policy and social inclusion are mutually exclusive. As demonstrated elsewhere, the mass banking with no-frills etc. can become a win-win situation for both. Basically banking services need to be "marketed" to connect with large population segments and these may be justifiable promotional costs. The opportunities are plenty.

- In the context of India becoming one of the largest micro finance markets in the world especially in the growth of women's savings and credit groups (SHGs) and the sustaining success of such institutions which has been demonstrated by the success of SEWA bank in Gujarat, low cost banking is not necessarily an unviable venture/proposition.
- The IBA may explore the possibility of a survey about the coverage in respect of financial inclusion keeping in view the geographical spread of the banks and extent of financial services available to the population so as to assess the constraints in extension of financial services to hitherto unbanked sections and for initiating appropriate policy measures.
- It may be useful for banks to consider franchising with other segments of financial sector such as cooperatives, RRBs etc. so as to extend the scope of financial inclusion with minimal intermediation cost.
- Since 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 this regard, it is worthwhile to emulate the example of 'e-Choupal' project brought forth through private sector initiative.

### **Conclusion**

It is becoming increasingly apparent that addressing financial exclusion will require a holistic approach on the part of the banks in creating awareness about financial products, education, and advice on money management, debt counseling, savings and affordable credit. The banks would have to evolve specific strategies to expand the outreach of their services in order to promote financial inclusion. One of the ways in which this can be achieved in a cost-effective manner is through forging linkages with

microfinance institutions and local communities. Banks should give wide publicity to the facility of no frills account. Technology can be a very valuable tool in providing access to banking products in remote areas. ATMs cash dispensing machines can be modified suitably to make them user friendly for people who are illiterate, less educated or do not know English.

To sum up, banks need to redesign their business strategies to incorporate specific plans to promote financial inclusion of low income group treating it both a business opportunity as well as a corporate social responsibility. They have to make use of all available resources including technology and expertise available with them as well as the MFIs and NGOs. It may appear in the first instance that taking banking to the sections constituting “the bottom of the pyramid”, may not be profitable but it should always be remembered that even the relatively low margins on high volumes can be a very profitable proposition. Financial inclusion can emerge as commercial profitable business. Only the banks should be prepared to think outside the box!