K C Chakrabarty: Social banking and finance – opportunities in inclusion

Session keynote address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the 2nd FT-YES Bank International Banking Summit, Mumbai, 15 October 2012.

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Mr James Crabtree, Mumbai Correspondent, Financial Times and moderator for the session, my fellow panellists Mr Y.M. Deosthalee, CMD L&T Finance; Mr Ajai Kumar, CMD Corporation Bank; Mr M.V. Tanksale, CMD Central Bank of India; Mr R.V. Verma, CMD National Housing Bank; Mr Ajay Desai, Chief Financial Inclusion Officer, Yes Bank and Mr Leonardo Rubattu, General Manager, Iccrea Banca; other important people sitting in the audience specially Dr Rana Kapoor, Founder, MD and CEO, Yes Bank and Mr James Lamont, Managing Editor, Financial Times; delegates to the conference; members of the print and electronic media, ladies and gentlemen. It is, indeed, a matter of great pleasure and privilege for me to be present here today at the 2nd FT-YES Bank International Banking Summit 2012 and share some of my thoughts with you on the topic for the Session: “Social Banking and Finance – Opportunities in Inclusion”. The topic is very relevant, particularly in the light of the prevailing global economic crisis, which was, in part, attributed to the financial system losing its social orientation and growing into an exclusive universe, disconnected from the real sector. Social banking and financial inclusion present a significant challenge and a unique opportunity to build a broad based and stable financial system, subservient and contributing to growth in the real sector and overall economic prosperity of the masses. It is also very germane to the overall theme of the conference on “Realigning the Global Banking System” as inclusiveness and social orientation needs to be the key pillar around which the post-crisis global financial architecture is developed. I, therefore, congratulate Financial Times and Yes Bank for including this theme in the conference and look forward to a useful brainstorming session ahead.

What is social banking?

Before delving into the nuances of social banking, let me briefly dwell on what is social business, or more specifically, social banking. In my opinion, any activity which is viewed by society as not being in sync with societal priorities would get weeded out in the course of time. Therefore, any business, in order to be sustainable, needs to be socially oriented. This is all the more true of banking business which, due to its financial intermediation function, has to necessarily be aligned to the developmental needs of the society that it operates in. Notwithstanding, banks being commercial organisations, must earn profit, else they would not remain viable or be able to absorb shocks. At the same time, they must serve a social purpose; otherwise, they will become irrelevant and unsustainable.

The banking business, globally, has followed pricing practices that have resulted in the poor subsidizing the rich. This has worked to the detriment of the poor, who have had to pay high cost for accessing financial services, often forcing them to rely on informal sources for their funding needs at exorbitant rates. This has severely curtailed the opportunities available to them to use the financial system to improve the quality of their lives. Therefore, intuitively speaking, to me, social banking is one where the rich subsidize the provision of financial services to the poor and where banking business is oriented towards serving the masses instead of exploiting them.

Thus, seen in a broader perspective, banking can never be “unsocial”. Hence, the terminology of “banking” and “social banking” can be used concomitantly. However, as the organizers of the conference have chosen the topic of Social Banking and finance, I would continue to use the prefix "social", though, I firmly believe that banking and finance should always be social to ensure their long term sustainability and viability.

Social banking and finance – more relevant than ever before

Why has social banking and finance become so relevant now? The global financial and economic crisis has had a significant negative impact on lives of individuals globally. People have lost their livelihoods, their homes and savings in the aftermath of the crisis. One of the prominent reasons for the crisis was that the financial system was focussed on furthering its own interests and lost its linkage to the real sector and with the society at large. The relevance of social banking and finance also arises from the realization that free market forces do not always result in greater efficiency in the financial system, particularly while protecting the interests of the vulnerable sections of society. This is due to the information asymmetry working against these sections, thereby placing them at a severe disadvantage.

Post crisis, social banking has become an important theme across the globe. The need for banks to be relevant to society, besides pursuing their own business interests, has been reflected in various measures introduced through legislations and regulations in several jurisdictions. The fact ,that developments in the financial world can have severe spillover effects on the real sector, thereby materially impacting the lives of the masses – has been the thought process behind these measures. The stability and strength of the financial system is, thus, a matter of public concern and is reflected in these steps.

It is pertinent to note that banks are an integral part of the social system. They draw resources such as manpower, funds, support services, etc. from the community, which also acts as customers for banks' services. Banks are, therefore, heavily reliant on society for their operations and it is, thus, fair to expect that banks reciprocate by ensuring that the interests of the society are taken care of through social banking measures.

History of social banks

Historically, the first social banks were founded in Italy in the 15th century. Their primary responsibility was to be an intermediary between those with money to save and those who needed money to do business. In India, the history of co-operative banks goes back to the year 1904, when the Co-operative Credit Societies Act was enacted. Thus, social banks are not a new concept but rather an idea that has had a long history both globally and in India.

Distinguishing features of social banking

The critical difference that sets social banking apart from conventional commercial banking is that though earning profit is one of the objectives of social banking, it would not be their *raison d'être*. Social banking would also be concerned about the community, about contributing to the well-being of the masses and ensuring that their activities are carried out in a manner that is in congruence with the broader goals of the society. They would not encourage businesses that harm the ecosystem and would support sustainable environmental practices through their lending policies.

Social banking would seek to closely understand the requirements of customers and develop products that are best suited to their needs. They work towards developing technology leveraged models that bring down the costs of providing services and make banking affordable to the masses. By extending the reach and penetration of banks, social banking tries to make banking services available to the marginalized segments of the society.

Social banking also needs to promote inclusion to address poverty

About 2.5 billion people across the globe do not have access to basic banking services. The unbanked population, which lives primarily in developing countries, comprises nearly half of the world's working-age population. Their exclusion from the formal financial system restricts their participation in the global economy and severely curtails the opportunities available to them to pull themselves out of poverty.

Banks should have a vested interest in poverty alleviation as improvement in the economic status of the poor would enable the latter's joining the formal financial system and becoming prospective bank customers. Social banking can contribute to poverty alleviation by developing low cost products customized to the needs of the poor and providing them access to affordable credit for entrepreneurial and emergency purposes. Social banking can, through financial literacy initiatives, generate awareness among the poor about financial products and their utility. Banks can also contribute towards making the poor creditworthy through training and counselling programmes.

Let me now briefly discuss the social banking initiatives in India.

Social banking as an instrument for financial inclusion – Indian experience

Though social banking initiatives were introduced in India long back through measures such as the cooperative banking movement, nationalization of banks, creation of Regional Rural Banks, etc, their success was largely constrained by the size and population of the country and non-availability of banking services. This constraint could be overcome only through the emergence of suitable technology and hence, in the last decade, with the developments in technology, financial inclusion has received a big boost in India and greater efforts have been laid on inclusive banking.

Inclusive growth in India: a key objective

- The Eleventh Five Year Plan (2007–12) envisioned inclusive growth as a key policy objective. The Plan document noted that economic growth had failed to be sufficiently inclusive, particularly after the mid-1990s. Though the Indian economy achieved high growth rates between 2003–04 and 2007–08, it did not result in unemployment and poverty reducing to tolerable levels. Thus, the Eleventh Plan Document tried to restructure the policies in order to make the growth faster, broad-based and inclusive. Huge investments in education, health and rural infrastructure were the key elements of the inclusive growth strategy as envisaged.
- Broadly, the policies aimed at increasing the income and employment opportunities and the financing of programmes capable of making the growth more inclusive, such as development of agriculture and small scale industries.
- It was recognized that state governments have an important role to play in achieving the objectives, especially in providing suitable infrastructure/ extension support for facilitating enhanced credit flow to agriculture.

Multi agency approach

We have a multi-agency approach to financial inclusion in India.

- The Financial Stability and Development Council (FSDC) is mandated, *inter alia,* to focus on Financial Inclusion and Financial Literacy issues.
- In order to further strengthen the on-going financial inclusion agenda in India, a high level ***Financial Inclusion Advisory Committee*** has been constituted by the Reserve Bank of India. The collective expertise and experience of the members of the committee will be utilised to pave the way for developing a viable and sustainable banking services delivery model focussing on accessible and affordable financial services, for developing products and processes for rural as well as urban consumers presently outside the banking network and for suggesting appropriate

regulatory framework to ensure that financial inclusion and financial stability move in tandem.

- Financial Sector Regulators including the Reserve Bank are fully committed to the Financial Inclusion Mission.

Financial inclusion – what has been done so far?

Some of the steps initiated for enhancing financial inclusion in India include:

- ICT based Business Correspondent (BC) Model for delivery of low cost door step banking services in remote villages is being implemented.
- Board approved Financial Inclusion Plans (FIPs) of banks for 3 years, starting April 2010 are being implemented, with close monitoring by RBI.
- Roadmap to cover villages with population above 2000 by March 2012 was prepared and successfully implemented. Process of ensuring coverage of villages with population below 2000 is underway.
- Mandatory opening of 25 % of new branches by banks in unbanked rural centres.
- Introduction of Basic Saving Bank Deposit Account for all individuals
- KYC documentation requirements significantly simplified for small accounts.
- Guidelines for convergence between Electronic Benefit Transfer and FIP have been issued.
- Pricing for banks has been totally freed. Interest rates on advances have been fully deregulated.

Approach adopted by RBI – some specifics

- In India, we have adopted a bank-led model for financial inclusion which seeks to leverage on technology. The financial inclusion initiatives would have to be ICT based and would ride on new delivery models that would need to be developed by the market participants to best suit their requirements.
- Our experience shows that the goal of financial inclusion is better served through mainstream banking institutions as only they have the ability to offer the suite of products required to bring in effective/meaningful financial inclusion.
- Other players such as mobile companies, etc. have been allowed to partner with banks in offering services collaboratively.
- We recognize that technology is the key to our financial inclusion efforts. Technology needs to be leveraged both for improving access to financial services and for bringing down the cost of providing these services. As a starting point, we have insisted that all bank branches including RRBs should be on CBS. We have encouraged a multi-channel approach including mobiles, hand held devices, smart cards, micro-ATMs, kiosks, etc for providing financial services. However, the front-end devices need to be seamlessly integrated with bank CBS systems.

Coverage

A village is considered to be covered by banking service if either a bank branch is present or a BC is physically present or visiting that village.

Availability

Availability of Banking Services means availability of a minimum of four products

i) A Basic Savings Bank Deposit Account (formerly termed as No-Frills account) with Overdraft Facility.

ii) A Remittance Product for Electronic Benefit Transfer and other remittances.

iii) A Pure Savings Product, ideally a recurring or a variable recurring deposit.

iv) Entrepreneurial Credit such as General Credit Card, Kisan Credit Card.

Challenges to social banking

The concept of social banking, despite its inherent merits, faces several significant challenges in the process of scaling up. An efficient business/ delivery model that is capable of delivering banking services to the masses in a cost effective manner is yet to be implemented by banks. While several delivery models have been experimented with, the same has not yet stabilized. Similarly, several alternate technology options are being tried out. However, the alternative that would be able to handle high volume low value transactions, cost efficiently, is yet to be crystallized. Banks also have to refine their pricing practices in order to ensure that the basic goal of social orientation is maintained while ensuring viability and sustainability of social banking initiatives.

Sensitization of bank's manpower on their role in implementing the bank's social banking measures is also a significant challenge as the rationale and guiding spirit behind the initiatives need to be conveyed to the operational staff on the ground. This is of utmost importance as they serve as the frontline contact of the bank with the target groups and hence, are a vital cog in the implementation of bank's social banking initiatives. Besides being technologically conversant with the innovative platforms being adopted by banks, the staff needs to have a behavioural orientation that grooms them to empathise with the vulnerable groups and gain their confidence.

The way forward

With the introduction of banking technology and the realization that poor are bankable, the coverage of unbanked population into the financial system is expected to improve. Financial inclusion, along with Government's developmental programmes, is expected to result in overall financial and economic development in the country. As in the case of most developing countries, extending the banking services to unbanked groups is expected to be the key driver for inclusive growth.

Developing innovative delivery channels would be the key to our financial inclusion initiatives. There are several success stories globally where market players have worked out innovative models, often harnessing on technology, to overcome financial exclusion barriers. Mobile phone services for instance, have been harnessed by several jurisdictions such as Kenya, through their M-PESA model, for providing access to financial services to people. The fact that there is a huge mass of people with mobile phones, but no bank accounts highlights the potential available through this channel. Similarly, use of microfinance, banking agents, etc by various jurisdictions has resulted in impressive gains from a financial inclusion perspective.

In India, the policy framework is already in place. However, an efficient business model and delivery platform for provision of services by financial service providers is still evolving. Banks, in collaboration with other stakeholders and civil society, are working towards stabilizing and scaling up their models for social banking. As mentioned previously, we are pursuing bank-led model which leverages on technology to expand coverage and minimise cost of providing service. We are technology neutral and banks can select any technology option. We encourage banks to develop models which can operate in a viable and sustainable manner.

Conclusion

In the wake of the financial crisis and growing disenchantment among the general public, reflected in the "Occupy Wall Street" and similar protest movements worldwide, the consequent reform measures have focussed on promulgating laws which seek to exercise greater control over the investment practices of banks and to limit speculation. What appears as a more promising approach in the long run is to develop socially, morally and ethically responsible banking practices oriented towards all stakeholders, even while pursuing profit motives. Social banking model can emerge as a very sustainable model that can emancipate the global financial system from some of the ills that plague it at the present moment.

The impetus for social banking can come from two approaches – one of them being through legal and regulatory requirements. This approach could, however, result in social banking being pursued only from a compliance perspective. The other alternative, which holds greater promise, requires a realisation by market players that social banking could be a viable business proposition. For this, banks need to be fully convinced that social banking is in their own interest and that success in pursuing this business model would ensure their long run sustainability and growth. It is well recognized that without voluntary efforts by banks, it would not be possible to scale up social banking into a viable alternative. Accordingly, in India, we have encouraged financial inclusion initiatives to be bank-driven and to be guided by Financial Inclusion Plans developed by the individual bank Boards with self-set targets.

As highlighted by the Nobel Peace Award Laureate and former Russian President Mr Mikhail Gorbachev, the imperatives for a better future are – peace, fighting poverty, promoting global social justice & common wealth, and protecting the environment. In our attempts to achieve these objectives, social banking would have to play a significant contribution.

I congratulate Financial Times and YES Bank for organizing this Summit and once again thank them for providing me the opportunity to be present here today. I look forward to an interesting and stimulating discussion with my learned fellow members on today's panel and hope that the session succeeds in generating ideas that financial market players, regulators and civil society can work on so as to make social banking a sustainable idea.

Thank You.

Select references

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