# Summary of the discussion

The subject was particularly important because while the issue of trade-off between growth and stability has received much global attention, equity and inclusiveness related issues are yet not seen as an associated problem. In that context, a particular distinction made in the paper between lending to the poor and the subsequent process of financialisation has many negative lessons to offer, since it was the latter that contributed to the crisis. The discussions mainly led to sharing of country specific and product specific experiences particularly from emerging markets such as Bangladesh, Brazil, China and India with regard to policies and procedures for lending to the poor and providing larger financial access to those who were excluded.

## Md. Abdul Quasem's opening remarks

Md. Abul Quasem, in his opening remarks, besides generally commenting upon the theme, shared the Bangladesh experience. He emphasized the importance of inclusive policy in small economies and the need for financial regulation to have a human face.

Irrespective of being too big or small, all units have the potential to survive. The SMEs in Bangladesh remained outside the threat of global melt down since they depended upon domestic supplies and markets. Though tax exemptions were not common, SMEs needed some public support. As SMEs needed to be nurtured, in Bangladesh central bank refinancing was made available to banks for their SME lending in the initial period. Gradually, private funding also came in and now the central bank monitors the bank funding to this critical sector to ensure geographical and demographic dispersion.

Micro-credit was another area which had shown significant growth and success. One of the reasons it managed to do so related to the relatively light touch regulations that the industry faces. A Micro-Credit Regulatory Authority (MRA) has been set up to achieve a right balance between ensuring adequate space for microfinance institutions to innovate and appropriate regulatory oversight which is also essential.

Commenting on the role of public policy, Md. Quasem stressed the importance given in particular to agricultural sector. Government had agreed to huge debt waivers to support agriculture, in spite of its potential adverse impact on credit culture. Mandated inclusion initiatives were sometimes construed as being distortionary such as the requirement in Bangladesh for banks and FIs to finance at least 15% of their total lending to women.

Referring to the role of alternate banks/not for profit entities in Bangladesh, he mentioned that even though most of these are outside the regulatory ambit, their role in financial inclusion has been laudable. Many of them have outperformed banks and remained insulated from the financial crisis. However, there has been some criticism of these entities getting endowment funds from the Government and then getting into commercial activities.

Md. Quasem raised the fundamental issue of the objectives of growth and commented that pursuance of growth per se had obvious limitations. It must be geared towards certain socio-economic objectives to remain sustainable and to lead a country towards a stage of all round development. The growth process also needs to take into account certain broader socio-economic and environmental concerns. Industrial growth for export earnings, for example, may be harmful if their effluents kill water bodies, aqua diversity, and ecology.

He argued that in some respects, smaller banks having diversified real sector exposure better serve the needs of local people as compared to big, multinational banks which are primarily focused on trading profits. It was necessary to monitor and restrict excess profits in the post crisis scenario. In Bangladesh, banks and non-banking financial companies were required to appropriate 20% of profits to reserves, before distribution of dividends.

He agreed that technology could be the answer to many problems of the excluded. He mentioned that as in Philippines and Brazil, Bangladesh had also introduced mobile banking service for receiving and paying cash through point of service (POS) led by banks.

In conclusion, he mentioned that in the post-crisis context, the voices of small stakeholders needed to be heard by regulators as part of a caring, consultative and participatory approach while addressing financial policy issues.

## Business correspondent model

Among various institutional arrangements, the huge success of the business correspondent model in Brazil, later implemented in India, was mentioned as a successful policy intervention. The number of BCs in Brazil was as high as five times those of the number of branches. The success of the model lies in the synergies between the banks and the BCs and the model did not involve many trade-offs. The banks see it as an opportunity to broaden their client base and reach markets at a lower cost, which were otherwise inaccessible for various inhibiting factors such as distance, illiteracy and social barriers. BCs could help in brand building and expanding inclusiveness. Under the BC model, it was clarified that the BCs were entitled to a fee from the banks and not permitted to levy any charges from customers strictly. All operational and legal risks remained with the banks. In India, concerns about possible adverse incentives to BCs in this model were handled upfront through adoption of appropriate technology protecting consumer interests and exercising sufficient control over BCs through regulatory guidelines. To a query it was incidentally observed that the favourable change in income distribution in Brazil in recent years should be attributed more to public and fiscal policy interventions along with inclusive policies in finance.

## Technology and related issues of security, accounting and credit-worthiness

There was a significant debate about the role of technology in particular of mobile baking and how that could be a game changer. It was emphasized that more imaginative interventions are needed as far as technology – particularly the mobile technology is concerned. In the context of China, it was mentioned that mobile companies had the biggest footprint. There were experiments to leverage on this strength and micro payments through mobile phones were already permitted. In the near future, mobile phones could start functioning as mobile banks. One of the problems encountered was non-standardized soft-ware due to various accounting practices creating silos. In this context, the need to have standardized payment, credit and accounting standards based on cash flows – instead of the traditional balance sheet and profit and loss accounts – for the poor and SMEs was stressed. Such standardization could result in effectively transforming mobile phones into effective channels for banking and related services. Such an effort would nevertheless need breaking down of regulatory barriers and better coordination among various regulators.

While switching over to mobile banking the consequent trade-offs were also discussed from security and prudential perspectives. There were obvious issues about retaining the rigor of KYC/AML norms. A larger issue was the nature of regulation – how to regulate a parallel banking system which may, over time, become larger than the formal banking system.

To resolve regulatory conflict, in Ghana mobile companies are not licensed by the central bank. The companies have to partner with banks and to address security related concerns such as KYC and AML issues and communication related barriers due to illiteracy, e-switch/biometric cards have been introduced.

It was clarified that the Indian approach of going for a bank-led model for mobile banking was informed by two key considerations – security issues and the float. Allowing mobile companies as BCs was intended to optimally leverage the footprint advantage that mobile companies have. A unique experiment of issuing biometric card of identification which can hold information on a variety of financial transactions is also under way.

The Indian policy approach to financial inclusion, it was highlighted, made a conceptual distinction between basic financial services and provision of credit. 'Inclusion' under basic financial services aimed at providing access to payment/remittance services and a simple savings account for safe keeping of money particularly by women. This should be treated as a public good, must be available risk free and at a lower cost. Provision of credit and other financial products such as insurance which are not risk free, should be treated as an add-on to the provision of basic financial services. This strategy was also expected to help building up transaction history for the poor over time, as a means of ascertaining credit worthiness.

An important issue raised in regard to 'credit worthiness' of small clients was that banks need to think innovatively out of the box, beyond credit bureaus and evolve a mechanism based on transparency of transactions – much as e-bay does for its sellers. Transaction history, based on cash flows, could be a strong indicator of credit worthiness. It was observed that in India, by providing incentives for roll over or for higher credit entitlement when timely payments are made, a credit history is built up incidentally for small borrowers.

## Cross subsidisation

A question seeking clarification on the issue of cross subsidization was raised in the context of Chair's initial remarks on how private banks can be incentivized to promote inclusive financing. There were also issues such as whom and what will be subsidized and how the policy should be designed. The discussion threw up several interesting points:

(i) In India, where priority sector targets are mandated on both private and public sector banks, though interest rate caps are not prescribed, even private banks hesitate to charge higher interest rates, since there is a moral pressure of harsher public policy intervention;

(ii) Private sector banks may consider lending to poor, despite lower returns, as a way of diversifying risk;

(iii) There are many externalities from the State when it provides certain overheads in technology, market infrastructure, social architecture etc., at public cost;

(iv) In self-help groups, the joint liability principle enables transfer of private information in small groups into useful credit information. Constitution of such groups is orchestrated by the State.

(v) Subsidisation occurs also when pricing is done on marginal cost principle and not on full cost principle.