

## **K C Chakrabarty: Financial inclusion and banks – issues and perspectives**

Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the FICCI (Federation of Indian Chambers of Commerce & Industry) – UNDP (The United Nations Development Programme) Seminar on “Financial Inclusion: Partnership between Banks, MFIs and Communities”, New Delhi, 14 October 2011.

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### **Role of FICCI and UNDP**

As you are all aware, financial inclusion is a mammoth task and it cannot be achieved without the active collaboration of all stakeholders. It is in this context that this particular seminar organised by Federation of Indian Chambers of Commerce and Industry (FICCI), which is an apex industry association and brings a large number of stakeholders under its fold, and United Nations Development Programme (UNDP), which is at the centre of the UN’s efforts to reduce global poverty, assumes significance. FICCI has been playing a leading role in policy debates touching social, economic and political issues and I believe that corporates have a great role to play in furthering financial inclusion. It is in their interest. UNDP, as I am aware, has always been a solution-oriented, knowledge-based development organization, supporting various countries to reach their development objectives and internationally agreed goals. The strength of UNDP is that it partners with people at all levels of society to help build nations as also helps build capacities for sustained development and to meet the emerging developmental needs. It also brings in global perspective which is much needed. Within the thematic area of poverty reduction, UNDP has also associated itself with state governments to facilitate the design and implementation of pro-poor and inclusive livelihood promotion strategies with focus on excluded groups such as women, Schedule Castes (SCs), Scheduled Tribes (STs), Minorities, below-poverty line and migrant households and involuntarily displaced people. It is indeed an opportune time for FICCI-UNDP to release the paper on “**A study on the progress of Financial Inclusion in India**” which aims to analyze the role played by banks in creating Financial Inclusion and the future strategy they need to adopt to make further progress.

The important objectives under Financial Inclusion were aptly deliberated by the Committee on Financial Inclusion and the Committee on Financial Sector Reforms headed by respected Dr. Rangarajan and Dr. Raghuram Rajan. These reports have spelt out the imperative need to modify the credit and financial services delivery system to achieve greater inclusion. The full implementation of the recommendations made in these Reports will definitely go a long way to modify particularly the credit delivery system of the banks and other related institutions to meet the credit requirements of marginal and sub-marginal farmers in the rural areas in a fuller measure.

## **National focus on inclusive growth**

Today, there is a national as well as global focus on inclusive growth. The Financial Stability and Development Council (FSDC) headed by the Finance Minister is mandated to focus on financial inclusion and financial literacy. All financial sector regulators including the Reserve Bank of India are committed to the mission. And, very publicly, so are banks and other financial sector entities. If we are advocating any kind of stability whether financial, economic, political or social and inclusive growth with stability, it is not possible to attain these goals without achieving financial inclusion. Financial inclusion promotes thrift and develops culture of saving, improves access to credit both entrepreneurial and emergency and also enables efficient payment mechanism, thus strengthening the resource base of the financial institution which benefits the economy as resources become available for efficient payment mechanism and allocation. Empirical evidence shows that countries with large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. Thus, financial inclusion is no longer a policy choice today but a policy compulsion. And, banking is a key driver for financial inclusion/inclusive growth.

## **Role of banks**

But, it is well recognized that there are supply side and demand side factors driving inclusive growth. Banks and other financial services players are largely expected to mitigate the supply side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. Access to financial products is constrained by several factors which include lack of awareness about the financial products, unaffordable products, high transaction costs and products which are inconvenient, inflexible, not customized and of low quality. However, we must bear in mind that apart from the supply side factors, demand side factors such as lower income and /or asset holdings also have a significant bearing on inclusive growth. Owing to difficulties in accessing formal sources of credit, poor individuals and small and micro enterprises usually rely on their personal savings and internal sources or take recourse to informal sources to invest in health, education, housing and entrepreneurial activities to make use of growth opportunities. The mainstream financial institutions like banks have an important role to play in overcoming this constraint, not as a social obligation, but as pure business proposition.

## **Financial inclusion – a global policy priority**

The importance of an inclusive financial system is widely recognized in the policy circles, not only in India, but has become a policy priority in many countries. Several countries across the globe now look at financial inclusion as the means of a more comprehensive growth, wherein each citizen of the country is able to use their earning as a financial resource that they can put to work to improve their future financial status, adding to the nation's progress. In advanced markets, it is mostly a demand side issue. Initiatives for financial inclusion have come from the financial regulators, the 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 United States, the Community Reinvestment Act (1997) requires banks to offer credit throughout their entire area of operation and prohibits them from targeting only the rich neighborhood. In France, the law on exclusion (1998) emphasizes an individual's right to have a bank account. The German Bankers' Association introduced a voluntary code in 1996 providing for an "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 United Kingdom, a "Financial Inclusion Task Force" was constituted by the government in 2005 in order to monitor the development of financial inclusion. 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 bank, insurance, and non-bank actors involved and delivery of the full range of affordable and quality financial services.

### **Definition of financial inclusion**

What is our definition of Financial Inclusion? *Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated mainstream institutional players.* It is in this context that I would like to point that MFIs/NBFCs/NGOs on their own would not be able to bring about financial inclusion as the range of financial products and services which we consider as the bare minimum to qualify as availability of banking services cannot be offered by MFIs/NBFCs/NGOs. But, yes, they have an immense and extremely important role to play in furthering financial inclusion in the sense that they bring people and communities into the fold of the formal financial system.

### **What it means to us? Objective**

Our broad objective is to take banking to all excluded sections of the society, rural and urban. Our attention was specifically attracted to provide banking services to all the 6 lakh villages and meet their financial needs through basic financial products like savings, credit and remittance for obvious reasons. Though, the focus initially was to cover villages with population above 2000 by March 2012, banks have since drawn up their Board approved Financial Inclusion Plans to put in place a roadmap for extending banking services in all villages in an integrated manner over a period of next 3 to 5 years.

### **Is it the first time?**

It is not that efforts have not been made in the past to promote financial inclusion. The Nationalization of banks, Lead Bank Scheme, incorporation of Regional Rural Banks, Service Area Approach and formation of Self-Help Groups- all these were initiatives to take banking services to the masses. The brick and mortar infrastructure expanded; the number of bank branches multiplied ten-fold – from 8,000+ in 1969 when the first set of banks were nationalized to 80,000+ today. Despite this wide network of bank branches spread across the length and breadth of the country, banking has still not reached a large section of the population. A number of rural households are still not covered by banks. They are deprived of basic banking services like a savings account or minimal credit facilities. The proportion of rural residents who lack access to bank accounts is nearly 40 per cent, and this rises to over three-fifths in the eastern and north-eastern regions of India. The major barriers cited to expand appropriate services to poor by financial service providers are the lack of reach, higher cost of transactions and time taken in providing those services. The existing business model does not pass the test of convenience, reliability, flexibility and continuity.

### **So, what has changed now?**

It is not correct to surmise that banks were uninterested in increasing penetration. They were constrained by their capacity/ability as, till a few years ago, appropriate banking technology was not available. But, now, with the availability of suitable banking technology, the time has come when the Indian banking system can make and deliver on that promise. Quite clearly, the task to cover 1.2 billion population with banking services is gigantic and, hence, banks have now realized that technology is the driving force for achieving this. Harnessing this power of technology for making the banking system more efficient for achieving the goals set

under financial inclusion is going to be a big opportunity as well as a bigger challenge for the banking system. We should also understand that poor people are bankable and there is tremendous potential for business growth by providing banking services to them. What we need is an appropriate business and delivery model.

### **Is financial inclusion a viable business model today?**

Contrary to common perception, financial inclusion is a potentially viable business proposition because of the huge untapped market that it seeks to bring into the fold of banking services. Financial inclusion, *prima facie*, needs to be viewed as “money at the bottom of the pyramid” and business models should be so designed to be at least self-supporting in the initial phase and profit-making in the long run. It is important to keep in mind that service provided should be at an affordable cost. It is also pertinent to note that providing subsidy does not necessarily lead to a better delivery mechanism.

### **What RBI has done? Removed all regulatory roadblocks**

It has been RBI's endeavour to remove all hurdles in the way of its regulated entities in achieving financial inclusion objectives. While I would mention a couple of enabling policy measures undertaken by RBI a little later, I would first like to highlight certain special characteristics of India's financial inclusion model.

- RBI has adopted a bank-led model as its main plank for achieving the goals under financial inclusion.
- Due to the constraints involved in going for a full-fledged brick & mortar branch model, RBI has adopted the ICT based agent bank model through Business Correspondents for ensuring door step delivery of financial products and services.
- The approach adopted has been technology and delivery model neutral, whether through handheld devices, mobiles, mini ATMs, etc.
- We have endeavoured to deliver a minimum of four basic products and services, viz. a savings account with overdraft facility, a remittance product, a pure savings product, preferably, variable recurring deposit, and an entrepreneurial credit product such as Kisan Credit Card (KCC) or General purpose Credit Card (GCC). Naturally, the front end devices must be able to transact all these four products and services.

RBI has undertaken a series of policy measures to make our unique model a success. Some of the important ones are:

- Relaxation on KYC norms:** Know Your Customer (KYC) requirements for opening bank accounts were earlier relaxed for small accounts in August 2005, simplifying procedure by stipulating that introduction by an account holder who has been subjected to full KYC drill would suffice for opening such accounts or the bank can take any evidence as to the identity and address of the customer to the satisfaction of the bank. During the year, it has been further relaxed to include job card issued by NREGA duly signed by an officer of the State Government or the letters issued by the Unique Identification Authority of India containing details of name, address and AADHAAR number.
- Simplified branch authorisation:** To address the issue of uneven spread of Bank branches, since December 2009, domestic scheduled commercial banks are permitted to freely open branches in Tier 3 to Tier 6 centres with 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 Reserve Bank in each case, subject to reporting.

- iii. **Pricing has been made free:** Banks have been given the freedom to price their advances.
- iv. **Liberalisation of Business Correspondents Model:** In January 2006, the Reserve Bank permitted banks to engage business facilitator and business correspondent (BC) as intermediaries for providing financial and banking services. The BC model allows banks to provide door step delivery of services especially “cash in – cash out” transactions at a location much closer to the rural population, thus addressing the last mile problem. The list of eligible individuals/entities who can be engaged as BCs is being enlarged from time to time. For-profit companies have also been allowed to be engaged as BCs. You would be happy to know that as on March 31, 2011, domestic commercial banks have reported deploying 58,361 BCs, providing banking services in 76,081 villages.
- v. **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 opening of more brick and mortar branches, besides the use of BCs, was felt. Accordingly, banks have been mandated in the Monetary Policy Statement – April 2011, to allocate at least 25 per cent of the total number of branches to be opened during a year in unbanked rural centres.
- vi. **Financial Inclusion Plan for Banks:** In our effort to achieve sustained, planned and structured financial inclusion, in January 2010, all public and private sector banks were advised to put in place a Board approved three year Financial Inclusion Plan (FIP) and submit the same to the Reserve Bank by March 2010. These banks prepared and submitted their FIPs containing targets for March 2011, 2012 and 2013. These plans broadly include self determined targets in respect of rural brick and mortar branches to be opened; business correspondents (BC) to be employed; coverage of unbanked villages with population above 2000 as also other unbanked villages with population below 2000 through branches/BCs/other modes; no-frill accounts opened including through BC-ICT; Kisan Credit Cards (KCC) and General Credit Cards (GCC); 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 implementation of these plans is being closely monitored by the Reserve Bank.

### **What has been done by banks so far? Snapshots from FIP**

A criticism that the bankers' often face is that they are not doing enough or that they are not sincere enough. But is that really true? Let me quote a couple of statistics from the consolidated FIP of the scheduled commercial banks to debunk some of these myths (Detailed statistics in Annex 1).

- i. **Coverage of villages:** Banks have, up to June 2011, opened banking outlets in 1.07 lakh villages up from just 54,258 as on March 2010. Out of these, 22,870 villages have been covered through brick & mortar branches, 84,274 through BC outlets and 460 through other modes like mobile vans, etc.
- ii. **Opening of No-frills accounts:** Basic banking “no-frills” account, with “nil” or very low minimum balance requirement as well as no charges for not maintaining such minimum balance, were introduced as per RBI directive in 2005. As on June 2011, 7.91 crore No-frills accounts have been opened by banks with outstanding balance of Rs.5,944.73 crore. These figures, respectively, were 4.93 crore and Rs 4257.07 crore in March 2010.
- iii. **Small Overdrafts in No-frills accounts:** Banks have been advised to provide small ODs in such accounts. Up to June 2011, banks had provided 9.34 lakh ODs

amounting to Rs.37.42 crore. The figures, respectively, were 1.31 lakh and Rs 8.34 crore in March 2010.

- iv. **General Credit Cards:** Banks have been asked to consider introduction of a General Purpose Credit Card (GCC) facility up to Rs. 25,000/- at their rural and semi-urban branches. The credit facility is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned. Based on assessment of household cash flows, the limits are sanctioned without insistence on security or purpose. Interest rate on the facility is completely deregulated. As on June 2011, banks had provided credit aggregating Rs.2,356.25 crore in 10.70 lakh General Credit Card (GCC) accounts.
- v. **Kisan Credit Cards:** Kisan Credit Cards to small time farmers have been issued by banks. As on June 30, 2011, the total number of KCCs issued has been reported as 202.89 lakh with a total amount outstanding to the tune of 1,36,122.32 crore.

Now, these figures in themselves may not seem very impressive considering the gargantuan task that we have at hand. But if we look at the progress that has been achieved in the last one and a quarter years, and if we are able to scale up and sustain our efforts, I am quite hopeful that the targets set by the banks and our objective of achieving universal financial inclusion is attainable. But, it is not automatic and cannot be taken for granted. There are a number of issues and challenges that have to be surmounted.

#### **Way forward – future of financial inclusion**

- i. One of the major challenges under Financial Inclusion has been addressing the last mile connectivity problem. For addressing this issue and for achieving the goals set, experts have recommended the Business Correspondent/Facilitator (BC/BF) model. Though the BC model may not be commercially viable at the initial stage due to high transaction costs for banks and customers, the appropriate use of technology can help in reducing this. The need is to develop and implement scalable, platform-independent technology solutions which, if implemented on a large scale, will bring down the high cost of operation. Appropriate and effective technology, thus, holds the key for financial inclusion to take place on an accelerated scale.
- ii. Banks need to perfect their delivery and business model. A number of different models involving handheld devices with smart cards, mobiles, mini ATMs, etc are being tried out and it is necessary that they are integrated with the backend CBS system for scaling up. A good delivery model is also needed and, perhaps, even more so if there is a glitch and customer grievances needs to be resolved expeditiously. Thus, the time is approaching when these various experiments with different models are taken to their logical conclusion and banks start scaling up their implementation. At the same time, banks must also have an integrated business model. These hold the key to the success and failure of the financial inclusion efforts.
- iii. In addition to this, RBI has advised banks to focus more towards opening of Brick & Mortar branches in unbanked villages. These branches can be low cost intermediary simple structures comprising of minimum infrastructure for operating small customer transactions and supporting up to 8–10 BCs at a reasonable distance of 2–3 kms. This will lead to efficiency in cash management, documentation and redressal of customer grievances. Such an approach will also act as an effective supervisory mechanism for BC operations. Another very important thing is that banks have to realise that for Business Correspondent (BC) model to succeed, the BCs, who are the first level of contact for customers, have to be compensated adequately so that they too see this as a business opportunity
- iv. As mentioned earlier, banks should strive to provide a minimum of four basic products and, in addition, design 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 the poor clients at an attractive pricing. Though the cost of administering small ticket personal transactions is high, these can be brought down if banks effectively leverage ICT solutions. This can be supplemented through product innovation with superior cost efficiency. Mobile banking has tremendous potential and the benefits of m-commerce need to be exploited.

- v. It is important that adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, etc. are available.
- vi. All stakeholders will have to work together through sound and purposeful collaborations to ensure appropriate ecosystem development. This would include government, both Central and State, Regulators, Financial Institutions, Industry Associations, Technology Players, Corporates, NGOs, SHGs, Civic Society, etc. Local and national level organizations have to ensure that these partnerships look at both commercial and social aspects to help achieve scale, sustainability and desired impact. This collaborative model will have to tackle exclusion by stimulating demand for appropriate financial products, services and advice with appropriate delivery mechanism and by ensuring that there is a supply of appropriate and affordable services available to those that need them.
- vii. 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

These days, it is difficult for central bankers like us to stop talking about financial inclusion once we start, I would nevertheless restrain myself. To sum up, financial inclusion is the road which India needs to travel towards becoming a global player. An inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process. Banks that have global ambitions must meet local aspirations. Financial access will also attract global market players to our country that will result in increasing employment and business opportunities. As we have all recognized, technology is a great enabler and has to act as a ladder to achieve the ultimate goal of providing financial services to the financially excluded. A line of caution here is that in order to serve millions of our poor villagers, what we need is “Technology with a human touch”. Banks should, therefore, take extra care to ensure that the poor are not driven away from banking because the technology interface is unfriendly. This requires training the banks’ frontline staff and managers as well as Business Correspondents on the human side of banking. Sufficient provisions should be built in the business model to take care of customer grievances. It can be summarized that the **“The future lies with those who see the poor as their customers”** as commerce for the poor is more viable than the rich. In this task, a concerted and structured effort by all stakeholders is necessary. The participants of this seminar should deliberate on and crystallize the role of each stakeholder – what banks should do, what society should do, what MFIs should do, and what FICCI/Corporates should do. Being a global seminar as UNDP is also a co-organizer, it should also be used as an opportunity to share experiences of different countries. I wish the deliberations of this seminar a success and do hope that a contour for a meaningful partnership between banks, MFIs and communities emerge from it. From the RBI side, I would only like to assure you that we would have an open mind to any suggestions that you may have on any issue which you still perceive as a regulatory bottleneck.

Thank you very much.

## Annex 1

S.N	Particulars	Mar 10- Actual	Mar 11- Actual	June 11- Actual	Mar 12- Target	Mar 13- Target
1	Villages Covered - Grand Total ( 2+3+4 = 5+6)	54258	100183	107604	218574	352269
2	Villages Covered - Total Branches	21475	22662	22870	24995	26440
3	Villages Covered - Total BCs	32684	77138	84274	192249	323699
4	Villages Covered - Total Other Modes	99	383	460	1330	2130
5	Villages Covered >2000	27353	54246	59640	86806	91440
6	Villages Covered <2000	26905	45937	47964	131768	260829
7	Urban Locations covered through BCs	433	3757	4524	6068	8614
8	No Frill A/Cs (No. in Lakh)	493.27	739.36	790.86	1125.06	1582.93
9	Amount in No Frill A/Cs (Amt in Crore)	4257.07	5702.94	5944.73	7449.86	8871.55
10	No Frill A/Cs with OD (No. in Lakh)	1.31	6.32	9.34	183.61	286.54
11	No Frill A/Cs with OD (Amt In Crore)	8.34	21.48	37.42	1008.04	1636.32
12	KCCs-Total-No. in Lakh	176.30	201.91	202.89	276.59	350.36
13	KCCs-Total-Amt In Crore	98749.5	132352.3	136122.3	144685.5	172775.0
14	GCC-Total-No. in Lakh	4.73	10.83	10.70	37.34	61.23
15	GCC-Total-Amt In Crore	753.49	2328.36	2356.25	4266.13	6715.07
16	ICT Based A/Cs-through BCs (No. in Lakh)	125.42	295.41	338.36	641.73	1014.74
17	EBT A/Cs-through BCs (No. in Lakh)	74.81	146.51	164.60	249.07	368.96

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