K C Chakrabarty: The first mile walk into financial inclusion – thinking differently

Address by Dr K C Chakrabarty, Deputy Governor of the Reserve Bank of India, at the inaugural session of the Financial Inclusion Conference 2012 "The first mile walk into the financial system", organized by FICCI and Sa-Dhan, New Delhi, 7 August 2012.

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Mrs. Naina Lal Kidwai, Vice President, FICCI and Country Head, HSBC India; Dr. Amiya Sharma, Chair, Sa-Dhan; Mr. Mathew Titus, Executive Director, Sa-Dhan, delegates to this Financial Inclusion Conference organized by FICCI and Sa-Dhan, ladies and gentlemen. I am pleased to be here with you all for the Financial Inclusion Conference 2012 that is being organized jointly by Sa-Dhan and FICCI. The theme this year "The First Mile Walk into Financial Inclusion" is both innovative in its concept and significant in its new approach to furthering Financial Inclusion. I was told that the objective of the conference is to deliberate upon the issues that the customer faces in his first walk to the financial system. Clearly, this is a customer centric approach and I congratulate the organizers for coming up with the idea. We are changing our thinking perspective from last mile (service provider perspective) to first mile (customer perspective). This change in thinking needs to be reflected in our actions also.

Financial inclusion efforts are not new; both the Government and the Reserve Bank have been pursuing this goal over the last several decades through building the rural cooperative structure in the 1950s, the social contract with banks in the 1960s and the expansion of bank branch networks in the 1970s and 1980s. These initiatives have paid off in terms of a network of branches across the country. Yet, the extent of financial exclusion has been staggering. Out of the 600,000 habitations in the country, only about 30,000 had a commercial bank branch. Just about 40 per cent of the population across the country had bank accounts. The proportion of people having any kind of life insurance cover was as low as 10 per cent and proportion having non-life insurance was an abysmally low 0.6 per cent. People having debit cards comprise only 13 per cent and those having credit cards only a marginal 2 per cent. The National Sample Survey data revealed that nearly 51% of farmer households in the country did not seek credit from either institutional or non-institutional sources of any kind.

These statistics, staggering as they are, do not convey the true extent of financial exclusion. Even where bank accounts are claimed to have been opened, verification has shown that these accounts are dormant. Few conduct any banking transactions and even fewer receive any credit. Millions of people across the country are thereby denied the opportunity to harness their earning capacity and entrepreneurial talent, and are condemned to marginalization and poverty.

A sound system of institutions and instruments of intermediation is essential for promoting an efficient system. Increasing access to credit for the poor has always remained at the core of Indian planning in its fight against poverty. Nationalisation of banks, massive expansion of branch network in rural areas, mandatory directed credit to priority sectors of the economy, subsidised rates of interest and creation of RRBs & NABARD are some of the notable measures in this direction. Though these measures resulted in impressive gains in rural outreach and volume of credit, the structure built up was "quantitatively impressive but qualitatively weak". We still have a long way to go to fully realize the original objectives of inclusive growth.

Recognizing this dilemma, the evolution of financial inclusion, that aims to broaden and deepen access to development finance for all, of which microfinance is a subset, is timely. Ultimately, it is a well functioning and efficient financial market which can deal holistically with provision of financial services to the economy. Building financially inclusive system is, therefore, an integral and core pillar of financial sector reforms.

Over the years, there has been substantive development in the architecture and thinking on financial inclusion. While there is no "one-size-fits-all" financial inclusion strategy or approach, it is important to recognize few core or necessary and sufficient conditions that are needed to maximize the benefits derived from such a strategy.

Financial inclusion should focus on

- Holistic approach to provision of financial services not just credit or deposit alone;
- Meeting the needs of small firms,
- Segments of population excluded by gender or remoteness

Role of microfinance in financial inclusion

The unique aspect of micro finance in India is that it is delivered through a variety of channels. These include branches of commercial banks and Regional Rural Banks (RRBs) directly dispensing micro credit and through their Business Correspondents (BCs), Self Help Groups (SHGs) linked to bank branches, cooperative banks and primary cooperative societies, micro finance institutions (MFIs) as NBFCs and in other forms, obtaining funds from a variety of sources, domestic and external. Ultimately, it is an issue of reaching out to low-income families in a cost-effective, hassle-free and sustainable manner, particularly to those who, otherwise, would not have had such access to financial services.

Microfinance, as a model, facilitates financial inclusion. The logic and rationale of SHG based microfinance has been established firmly enough to prove that microcredit has effectively graduated from an "experiment" to a widely-accepted paradigm of rural and developmental financing in India. This is no mean achievement. In fact, to the extent that People's mindsets are the biggest roadblock in the success of an innovation, it may well be one of the most important steps in the saga of microfinance.

Microfinance is recognised as a cost effective and sustainable way of taking the banking system to the rural poor. The broad principle behind microfinance initiatives is: (i) to act as a cost effective avenue for the formal financial sector to expand its coverage of poor; (ii) to develop effective collateral substitutes; (iii) to emphasize on the poor masses, both rural and urban, especially women; and (iv) to focus on the objectives of macro-economic growth. Indirectly, microfinance improves schooling, health and women's empowerment. Globally, in the last two decades, the microfinance sector has opened up considerably. In the early 1990s when it was realized that microcredit providers could recover loans to poor and low income people as well as cover their costs, focus was on a single product (credit) which was delivered by specialized microfinance institutions. Microcredit, subsequently, developed into microfinance and then, into the concept of building entire financial systems for the poor, focusing on inclusive growth.

Microfinance services, both by SHG model as well as the retail lending model, have been contributing to this agenda. Microfinance has been found to facilitate three main developmental outcomes:

- It enables poor households to access services at the time of need
- It is associated with improvement in economic welfare of households
- By supporting women's economic participation, it helps to improve livelihood, empower women and promote gender equity

Our approach to financial inclusion

(a) Bank led model

- In India, we have adopted a bank- led model for financial inclusion, which seeks to leverage on technology. The FI 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 have been allowed to partner with banks in offering services collaboratively.

(b) Minimum bouquet of products and services

To meet the criterion of availability of banking services, a minimum of four basic products must be offered to customers:

- a check-in account with emergency credit facility
- payment services and remittance facility
- a pure savings product such as a recurring deposit
- facility of entrepreneurial credit to deserving people

(c) Technology driven – but technology platform neutral

The task of Financial Inclusion is gigantic and cannot be done without actively leveraging technology and without the involvement of society as a whole. The Financial Inclusion strategies and delivery models being developed by banks are primarily technology driven. However, we have consciously ensured that the models adopted by banks are technology neutral, which facilitates easy up-scaling and customization, as per individual requirements.

(d) Combination of branch and BC Structure

A combination of Brick and Mortar structure with Click and Mouse technology will be helpful in extending financial inclusion, especially in geographically dispersed areas. Banks need to make effective use of technology to provide banking services in remote areas through the BC model. The BC model allows banks to provide doorstep delivery of services, especially cash transactions. To ensure increased banking penetration and control over operations of BCs, more Brick and Mortar branches are needed. In April 2011, banks have been mandated to allocate at least 25 per cent of all new branches to unbanked rural areas. Banks have also been mandated to open intermediary brick and mortar structures between the base branch & customer locations, which will lead to efficiency in cash management, documentation, redressal of customer grievances and close supervision of BC operations.

(e) Structured, planned approach

We have a structured and planned approach to financial inclusion wherein all banks have prepared Board approved Financial Inclusion Plans (FIPs) with a three year horizon extending up to 2013, containing self-set targets which are congruent with their business strategy and comparative advantage. The initial goal of providing access to banking services to all villages with population more than 2000 by March 2012 has been successfully met and we are on our way to ensure the same for all villages in a time bound manner. The focus has now shifted from just opening of accounts to the volume of business transacted in these accounts, which is the key for making the FI model a success.

BC based delivery model

Delivery of financial services through the BC model would be key to the success of our financial inclusion initiatives. If the bank-led model is to succeed, it is imperative that it is able to leverage upon BCs to deliver efficient and cost effective access to services. However, our current experience is that the BC based delivery model is still evolving. While banks are experimenting with various ideas in search of the optimal delivery mechanism, it still continues to be the weakest link. The BC model has faced challenges from various sources such as viability issues resulting from delays in payment of remuneration to field BCs, technology and connectivity issues, turnover of BCs and building up faith and acceptability of BCs among the targeted population.

I hope that major players in this segment will come up with suggestions to overcome the problems currently being faced by the industry and work towards making it a success. I would also like to congratulate the organisers of this conference as this important aspect is being deliberated upon for the first time.

Where do non-mainstream institutions like MFIs fit in?

Though, we are of the belief that sustainable financial inclusion is achievable only through mainstream financial institutions i.e. banks, as the penetrative reach of banks is low and they have still not been able to reach a large number of villages in the country, other intermediaries, which have the ability to reach the excluded segments of the society are required. Microfinance institutions fill this niche space and to that extent, play a critical role in financial inclusion. The MFIs have served the underserved/un-served populace in the last few years and have improved access to credit. It is our considered view that in the next decade, MFIs will help in financial deepening and will continue to remain an important segment of the Indian financial market keeping in view the present level of penetration of the banking system.

The conceptual framework underlying MFIs, however, calls for a change. They must revisit their business model to support the income earning ability of the borrower. MFI's will have to take initiatives to retool the product design towards garnering new customers and for acquiring more share of the market. MFI's will have to re-engineer the customer responsive processes so as to create a favourable climate for doing business. They will have to revisit their mission and business strategy and reinvent the sector as a community relevant to public and policy support. In the long run, they have to arrive at a firm position on their existence by evolving, either as banks or BCs, or continuing as NBFCs in a niche market.

In a nutshell, evidence suggests that poverty reduction strategies are successful in countries which adopt inclusive policies. Building inclusive financial systems that are both financially and socially sustainable is a fundamental requirement of any poverty reduction strategy. Two basic issues that need to be understood while helping people walk the first mile into financial inclusion are:

- Financial Inclusion programmes should be implemented on commercial lines and not on a charity basis, in order to ensure its sustainability. It is important that banking with the poor is perceived and pursued as a viable business model.
- While poor need not be subsidized, it is important to ensure that they are not exploited. The need is to ensure that poor people who deserve credit are provided access to timely and adequate credit in a non-exploitative manner.

I am aware of the good work that Sa-Dhan has done over the past many years. I appreciate the vast and diverse membership of the association and look forward to their contribution in enhancing financial inclusion. I especially look forward to the work of expanding in the poorer districts of India and those that are affected by natural and other disasters, which restrict the presence of banks. Given the paucity of financial literacy, I, particularly, am looking forward to high quality awareness building program which will enable the poor households to participate more actively in utilising financial services for their own benefit.

I urge upon every stakeholder to contribute towards making our goal of financial inclusion a reality. Some of the important areas that require more attention are timely access to affordable financial services including credit, savings, insurance, pension and money transfer, responsible behaviour of the service providers, electronic modes of money handling, livelihood and enterprise creation, and a sound regulatory mechanism that oversees all the above. This requires a complementary and supportive interplay of multiple institutions, channels, models and experiments.

I hope that the conference would deliberate upon the above issues and come up with definitive strategies on the way ahead. I look forward to the continued service of the microfinance sector and its collaboration with the Government and RBI. I wish the conference all the very best.

Thank You.