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Financial Inclusion As A Business Opportunity For Banks And Mfis

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Abstract

Financial inclusion, implying expanding access to financial services to those currently not accessing them, is an important objective in many developing countries. Financial inclusion plays a major role in driving a way the poverty from the country. Financial inclusion refers to delivery banking services to masses including privileged and disadvantaged people at an affordable terms and conditions. The three major aspects of financial inclusion are (i) access financial market (ii) access credit market (iii) learn financial matters. Reserve bank of India and government play and important role in promoting financial inclusion for economic growth. Access to finance by the poor, disadvantaged and underprivileged group is a prerequisite of poverty alleviation on one hand and the economic growth on the other. In the struggle against poverty, the financial inclusion is a crucial element. RBI has also adopted two strategies to generate great awareness and expand the reach of banking services which can be termed as empowerment and protection. This paper addresses all concerned issues involved in achieving the national objective of achieving the complete financial inclusion. This paper critically evaluates the initiatives taken by the Banks in financial inclusion and MFIs, efforts made for IT enabled financial services, on the basis of the objective data derived from the RBI'S reports and other empirical studies.

The paper also explain the further opportunities, scope and challenges for financial inclusion as a Business Opportunity for Banks and MFIs. In India a day will come when all Indian have their bank accounts and everybody will take part in financial inclusion.

KEYWORDS: *Financial Inclusion, Micro finance, RBI, National Objectives, poverty alleviation, Economic Growth, Banks, Credit*

Introduction

Financial Sector Reforms, is all about universal access to a wide range of financial services at a reasonable cost. "Financial inclusion does not just mean credit for productive purposes, it also means credit for healthcare emergencies or to pay lumpy school or college fees".

Simply put, financial inclusion is beyond opening of accounts and depositing the subsidy money in their accounts to avoid corruption. UN report on building inclusive financial sectors for development defined an inclusive financial system as one which provides credit to all “bankable” individuals and firms; insurance to all insurable individuals and firms; and savings and payment services for everyone. Financial inclusion does not imply that everyone will use all available financial services rather everyone has the option to use them. A continuum of financial services needs to be made accessible to individuals as they improve their standard of living. Lack of access to financial services in most of rural areas due to high informative barriers and low awareness, poor functioning and financial history of financial institutions, near absence of insurance and pension service create the need and scope of financial inclusion. There is recognition that in countries at all income levels, there are population groups that are not adequately serviced by the formal financial system. Financial inclusion involves expanding their access to the financial system at an affordable cost. Fruits of development have hardly reached to nearly half of Indian population because no access to loan and insurance and this raises most pertinent issue of financial inclusion. It is a policy of involving a wider section of population deposit mobilization and credit intermediation.

In developing countries, the growth of microfinance institutions (MFIs) which specifically target low income individuals are viewed as potentially useful for promotion of financial inclusion. Even though MFIs at present, mainly offer only credit products; as they grow, they are likely to expand their product range to include other financial services. By partnering with MFIs, mainstream financial service providers could expand their outreach Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. Financial products & services are identified as basic banking services like deposits accounts, institutional loans, access to payment, remittance facilities & also life &non life insurance services. The following are the denotation & connotation of financial inclusion in India.

1. Affordable credit
2. Savings bank account
3. Payments & Remittance
4. Financial advice
5. Credit/debit cards
6. Insurance facility
7. Empowering SHGs(self-help groups)

Objectives

The objective is to take banking to all sections of the society, rural and urban which are excluded. Attention specifically attract to provide banking services to all to meet their financial needs through basic financial products like savings, credit, remittance and insurance for obvious reasons.

The objectives for this paper are as follows:

• To analyse the different approaches of financial inclusion.
• To examine the role of MFIs and Banking System in extending banking services for financial inclusion

Scope of Financial Inclusion In Banking Sector And MFIs

Despite witnessing substantial progress in financial sector reforms in India, it is disheartening to note that nearly half of the rural households even today do not have any access to any source of funds- institutional or otherwise. Hardly one-fourth of the rural households are assisted by banks. Hence the major task before banks is to bring most of those excluded, i.e. 75% of the rural households, under banking fold. But the task is not so easy since they are illiterate, poor and unorganized. They are also spread far and wide. What is needed is to improve their living standards by initiating new/increased economic activities with the help of banks, NGO‟s and local developmental agencies. To start with, it is necessary to develop a fair understanding of their profile. So there is a need for the formal financial system to look at increasing financial literacy and financial counselling to focus on financial inclusion and distress amongst farmers. Indian banks and financial market players should actively look at promoting such programs as a part of their corporate social responsibility. Banks should conduct full day programs for their clientele including farmers for counselling small borrowers for making aware on the implications of the loan, how interest is calculated, and so on, so that they are totally aware of its features. There is a clearly a lot requires to be done in this area.

Role of Banks

It is well recognised that there are supply side and demand side factors driving inclusive growth. Banks and other financial services players largely are 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 not convenient, inflexible, not customised 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 microenterprises usually rely on their personal savings or 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 this effort, not as a social obligation, but as pure business proposition.

Role of banking system in extending banking services for financial inclusion.

Indian banking system has exhibited tremendous growth in extending its reach,coverage & delivery of financial products to the mass ever since 1881. The All India Rural Survey committee in 1954 recommended the creation of a state sponsored bank to promote rural penetration. Accordingly, SBI was established in 1955. Another step in this direction was taken in 1969 when 14 major commercial banks were nationalized followed by six more in 1980. This strengthened the concept of socialistic & welfare state stature of the country. Lead bank scheme was launched in 1970 to increase banking penetration with special focus on the districts. The emergence of RRBs in 1976 blended the skills of commercial banks with the grass root presence of the cooperative banks helped the mass to access to institutional credit. NABARD established in 1982 regulated institutional credit for agriculture & rural development. Talwar committee &Goiporia committee in the early eighties have made many recommendations to improve the customer services in India. Following are some of the steps undertaken by RBI:

The RRBs have been advised to allow limited overdraft facilities in no-frill accounts without any collateral. The idea was that provision of such overdraft facilities provides a ready source of funding to the account holders who are thereby inducted to open such accounts.

Banks also have been advised to provide a General Purpose Credit Card (GCC) at their rural & semi urban branches. Bhumuheen‟ credit card facility has been arranged apart from Kisan credit cards for the rural & semi urban tenant farmers, landless labourers On the behest of the RBI, SHG & bank linkage programme has been initiated which has been a major micro finance programme in the country.

The banking industry has shown tremendous growth in volume and complexity during the last few decades. So, this lead to the emergence of for Financial Inclusion as a strategy to bring so called excluded people in to the mainstream. Financial inclusion is delivery of banking services at an affordable cost to the vast sections ofdisadvantaged and low-income groups. 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. Although credit is the most important component, financial inclusion covers various financial services such as savings insurance, payments and remittance facilities by the formal financial system to those who tend to be excluded.

Change in the approach of Banks

Only access to credit or banking is NOT the financial inclusion: Achieving complete Financial Inclusion: It is often noticed that mere opening a Bank Account is taken or claimed as achieving the target of financial-inclusion. Many empirical studies and Usage Analysis reveal that after opening such bank accounts, hardly there are any transactions take place in such bank accounts. Banks must genuinely strive to provide the directed services under the category or scheme of financial inclusion to the rural population, since they are the main pillars for the desired success.

Microfinance Institutions (MFIs)

Micro finance: Meaning and Issues of Concern Microfinance programmes are intended to reach poor segments of society as they lack access to financial services. It, therefore, holds greater promise to further the agenda of financial inclusion as it seeks to reach out to the excluded category of population from the banking system. The predominant micro finance programme namely SHG bank linkage programme has demonstrated across the country its effectiveness in linking banks with excluded category of poor segments of population. In this process, the role of development NGOs is quite pronounced in providing the last mile connectivity as enablers and catalyst between the SHGs / Village level co-operatives and the banks. This is also supplemented by the MFIs delivering credit.

Microfinance has drawn attention to an entire sector of borrowers who had been previously poorly served by the formal financial sector - and MF has demonstrated how to make lending to this sector a viable proposition. However the rates of interest charged are quite high, typically 12 to 30 per cent, mainly on account of the high transaction cost for the average loan size that can be quite small. Compared to the informal sector, perhaps the rates are lower, but issues are raised whether these rates are affordable - in the sense whether they would leave any surplus in the hands of the borrowers and lead to higher levels of living. For commercial banks, the lower cost of funding, advantages of size and scale gives scope for cross subsidization and their interest rates are more competitive compared to the MFIs, but they have not been as successful in dealing with the last mile issue. The partnering with SHGs and MFIs with reasonable cost of funding by the banks has been seen as a more optimal approach till now

The MFIs have served the underserved/unserved populace in the last few years and improved access to credit though there have been quite a few debatable issues on the style of corporate governance and ethics of conducting business on part of some of the MFIs. However, it has been often realized that the MFIs do help in financial deepening and can 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 requires a change. MFIs will have to revisit the mission and business strategy and reinvent the sector to remain relevant in the system. A new category of ‘Non Banking Financial Company-Micro Finance Institutions’ (NBFCMFIs) prescribed by the Malegam Committee (2011), created in December 2011 by RBI, is also facing difficulties primarily into micro financing. The NBFC-MFIs has got some relief from the RBI, which issued revised ‘Directions cum Modifications’ in August 2012, (RBI, 2012). On this background, these institutions have to revisit their business models to support the income earning ability of the borrowers and, at the same time, they remain economically viable.

NBFC-MFIs will have to work hard in pursuit of transparency and responsible finance, shaking off the perception that their motto is profiteering at the cost of the poor but not profitability for sustainable and viable growth on one hand and take initiatives to retool the product redesign for garnering new customers and acquiring more share of the market on the other.

Financial Inclusion – A Global Policy Priority

The importance of an inclusive financial system is widely recognised 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 neighbourhood. In France, the law on exclusion (1998) emphasises an individual's right to have a bank account. 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.

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. 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

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.

Financial Inclusion as a Business Opportunity vis-à-vis ProfitableModels for Financial Inclusion

Financial inclusion initiatives would provide banks with a low-cost and stable source of funds, helping them improve their asset-liability management (ALM). Rural India presents a remarkable opportunity for banks and financial institutions to seek their fortunes and bring prosperity to the aspiring poor through financial inclusion. In a fast growing economy like India the poor are the middle class of tomorrow and banks could, therefore, ill-afford to ignore this segment. Banks, however, argue that while the benefits of financial inclusion can be easily understood, the costs of serving the poor can be significant in the short-term, thereby impacting profitability. Banks, therefore, need to take bold decisions and reach out to rural India with strategies and business models which are beyond the realm of conventional thinking. Banks should refrain from deliberately adopting a uniform business model. Banks need to build its own strategy in line with its business model and comparative advantage.

A successful model should also represent a better way than existing alternatives and also answer management guru Peter Drucker's age-old questions:

(a) who is your customer? (b) What does the customer value? & (c) How do you deliver value at an appropriate cost?

Profitable models for financial inclusion could, therefore, have the following feature

Offering a clear customer proposition and customized bouquet of products:- To succeed in their financial inclusion initiatives, banks would need to offer customers a clear proposition and a customized bouquet of product offerings. Banks need to offer the following services at a minimum costs and charges, as part of an overall 'package' to attract customers:-

♣ Advice on monetary issues, problems, needs and plans

♣ Savings cum Overdraft account;

♣ Remittance-products;

♣Kisan Credit Card/General Credit Card

♣ Disbursements of Grants & Financial Assistance awarded by & in accordance with the Central Govt.,

State Govt.,Local authorities, other Funding agencies, NGOs, etc.;

♣ Micro-Credits as per Bank's own schemes;

♣ Govt. directed Priority sectoral lending

♣ Entrepreneurial Credit

♣ Micro-Insurance. -Each of these offer significant value to customer and enable banks to generate value through transaction fees.

(b) Scalable business model with simple, user friendly low-cost technologies:- Profitable business models, (Raj, 2011) would need to be scalable and incorporate simple, user-friendly and low-cost technologies so that investments would be recouped and profits begin showing up as the number of people serviced by a particular branch or outlet increases over time.

(c) Collaborate with local agents and for-profit companies:- According to consulting giant (Raj, 2010 from Chaia et al., 2010), the basic problem of 'last mile access' can be solved if banks can team up with retail outlets (business correspondents) in low-income, often hard-to-reach areas to offer financial services to rural masses, thereby, creating value both for themselves and their customers.

(d) Banks need to learn from both corporate India and the informal sector:-Banks need to innovate and improve service levels in order to provide the same level of accessibility as the local money lender, friend or relative and open branches/banking outlets in villages as inclusive banking goes beyond the conventional notions of commercial banking.

(e) Subsidiary model to drive down costs:-Indian banks should explore the subsidiary route to drive down distribution costs in their financial inclusion drive.
(**f) Strategy to gain benefits from Government scheme of MGNREGA :-** Banks need to mould their strategies to gain benefits amendments made in August 2011 making mandatory under the law for state governments to ensure that every beneficiary of the MGNREGA scheme has a bank/post office account and the disbursements are made exclusively through these channels, which provide opportunities to the banks and positively benefit financial inclusion initiatives.
(g) Innovate and test-market pilot products/services:-Banks need to keep their MIS updated and keep ground realities in mind while designing their products/services for the poor. McKinsey's report (2010) also suggests that financial service providers should test-market low-cost pilots to see which products/services are found acceptable before large-scale introduction.

Conclusion

These days, though 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 recognised, 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 in-built in the business model to take care of customer grievances.

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