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Theme 224

THE BUSINESS OF FINANCIAL INCLUSION

PART II

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SIB STUDENTS' ECONOMIC FORUM

JULY 2010

Theme No. 224 : THE BUSINESS OF FINANCIAL INCLUSION - PART II

What were the initiatives by the Goverment and the RBI for facilitating financial inclusion in India so far?

In the past, various regulatory measures were taken by the RBI to facilitate financial inclusion. In the early 90s, banks were allowed to open savings accounts for Self Help Groups (SHGs), which were neither registered nor regulated. An SHG is a group of 15 to 20 members from very low income families, usually women, who mobilize savings from members and use the pool to give loans to those members who need them, with the interest rates on deposits and loans being determined entirely by members. NABARD launched the SHG-Bank Linkage Program in 1992 to forge synergies between formal financial system and informal sectors. Under this programme, banks provide loans to the SHGs against group guarantee. The quantum of loan could be several times the deposits of SHGs with the banks. The penetration achieved through SHGs has been very significant. As per NABARD's report on status of microfinance (2008-09) about 86 million poor household are covered under the SHG-Bank Linkage program with over 6.1 million saving-linked SHGs and 4.2 million credit-linked SHGs.

The mandated priority sector lending is aimed at the objective of furthering financial inclusion. Priority sectors broadly include agriculture and allied activities, micro and small enterprises, education, housing and micro-credit. The commercial banks have allocated 40 percent of their lending to the priority sectors. The requirement of priority sector lending does not distort the efficiency of the system, as all the usual prudential norms for income recognition, asset classification, provisioning and risk weighting are equally applicable to such loans and do not add undue risk to the bank's balance sheet.

The issuing of license by the RBI to open bank branch has been used as a regulatory tool for furthering financial inclusion. Branch licenses in urban centres are linked to the number of branches opened in under-banked districts and states.

In 2005, the RBI directed the banks to offer the facility of 'no frills' account to any person desirous of opening such simple accounts. These accounts have nil or low minimum balances and charges, and have limited facilities. Also, relaxations in KYC (Know Your Customer) norms are allowed while opening accounts of low income and poor people who may not have any document of identity or proof of address. Simpler KYC norms are allowed for small value accounts where the balances in the account do not exceed Rs.50, 000- and where the annual credits in the account do not exceed Rs. 100,000-

The govt. has set up two funds – the Financial Inclusion Fund, to meet the costs of developmental and promotional interventions towards financial inclusion, and the Financial Inclusion Technology Fund, to meet the costs of technology adoption. These funds have an overall corpus of Rs. 500 crore. The commercial banks are required to prepare Financial Inclusion Plan (FIP) based on comparative advantage of each bank.

The govt. has constituted the Unique Identification Authority of India (UIDIA) to issue a Unique Identification Number (UID) with biometric recognition to every resident of the country. The govt. is looking into the possibility of routing food and fertilizer subsidies through the banks accounts opened on the basis of UID to avoid misappropriation of funds. Based on UID, easy identification can be ensured and banking services can be provided. Using UID for fulfilling KYC for small value accounts will further facilitate financial inclusion.

What is meant by 'Branchless Banking' in the context of financial inclusion?

The traditional banking model is termed as 'brick and mortar model' which denotes physical presence of the bank branch in a particular locality. The expansion of commercial banks definitely helped in financial deepening of the economy by extension of the varied, customized and sophisticated services in every distant part of the country. But there are still excluded areas where the establishment of full-fledged commercial bank branch is not found to be commercially viable. It is impossible to provide access to a bank account to every household through a bank branch. The poor and the excluded segment of the population should be provided banking and financial services at their place of residence, by doorstep banking or village banking. An innovative model proposed for effective dissemination of banking services in villages is called 'Branchless Banking' or 'Business Correspondent' model of banking. Branchless banking can greatly extend the distribution of financial services to poor people, both by reducing the cost of delivery – of building and maintaining branches and handling low value transactions directly – and by reducing the cost to customers of accessing services – of travel and queuing time.

Also, in rural areas, cash transactions are more prevalent than the electronic means of payments. This requires provision of financial services such as simple savings loan and remittance products by engaging business correspondents, known as agents of banks, who are allowed to undertake banking transactions, including 'cash in cash out' transactions at locations close to the customer.

What is meant by Business Correspondent (BC) model for financial inclusion?

The 'branchless banking' model is implemented via 'Business Correspondents'. Under the BC model, non-governmental organizations, self-help groups, micro finance institutions, other civil society organizations and specially designated individuals will act as agents of the bank to carry out banking transactions on behalf of the bank. The business correspondents would, on behalf of the bank, for a commission, disburse small value credit, recover principal and interest, collect small deposits, receive and deliver small value remittances, and sell micro-insurance, pension and other products. The BCs will be under the control of the branches. The banks will account for the transactions by the end of the day or the next working day from the date of transaction. The banks will be held responsible to the customer for the acts of the BCs. It is envisioned to have at least one BC in every village.

Branchless banking is a technology enabled low cost alternate delivery channel. This facilitates basic banking services to the rural communities at their doorstep through business correspondents at an affordable cost, in a secured manner. There is a risk for banks in engaging BCs as they are not as skilled and trained as a regular bank employee. The use of smart hand-held devices mitigates these risks.

The BC idea came from Brazil where retail vendors, lottery outlets and post offices acted as bank branches for customers. Banking agents process transactions with point-of-sale (POS) devices such as biometric or smart card readers, barcode scanners and sometimes personal computers that connect with the bank server using dial-up or other data connection means, including mobile phones. The idea has spread to several other Latin American countries. It is estimated that 40 banking agents can be engaged for the price of one branch.

How can technology accelerate the process of financial inclusion?
Banks and financial institutions now count on technology to improve transaction processes and analyze information with the objective of improving their services and meeting the needs of prospective customers. Use of technology has cut down expenditures on financial transactions, and enriched competitiveness and efficiency of financial institutions.

There are today companies like FINO (Financial Information Network and Operation Limited) and BASIX who operate as BCs and they service millions of customers of various banks with whom they have tied up. Thus banking services are offered in a less expensive way.

Mobile technology is deployed in accelerating financial inclusion. With the exponential growth of mobile connections in India, mobile banking applications can be used as an efficient channel to deliver financial services to the farthest parts of the country at lower costs. Bankers and telecom operators join hands to tap the rural and semi urban markets. The secure mobile technology platform eliminates the high cost of setting up branches and ATM networks. IT-Telecom platform can be linked to the banks' centralized system. The back-end operations – transaction between the BC and the bank - can be routed thorough ATM, internet or mobile banking. VSAT (very small aperture terminal) can be used for establishing network with remotely located branches with central database of the banks. Thus wireless connectivity to core banking solution platform is possible via satellite and banking transactions are facilitated to the rural populace.

Customers are provided with smart cards which act as e-purse and e-passbooks. This is a fully functional card built on a single chip. Smartcard needs a host system usually a reader for its power requirement and other operations and this can be a low powered equipment. The enrollment and verification are authenticated by using a finger print scanner. This will also print out transaction receipt for the customers. The scanners are linked to a smart card enabled mobile phone using the GPRS technology. Thus, transactions are authenticated and processed on a real time basis.

Thus, financial inclusion will be a great movement of rural transformation with the concerted efforts of the Government, the RBI, commercial banks and technology service providers.

Branchless Banking via Business Correspondent Model

The following individuals/entities can be engaged as Business Correspondents (BCs)

Individuals like retired bank employees, retired teachers, retired government employees and ex-servicemen, individual owners of kirana / medical /Fair Price shops, individual Public Call Office (PCO) operators, agents of Small Savings schemes of Government of India/Insurance Companies, individuals who own Petrol Pumps, authorized functionaries of well run Self Help Groups (SHGs) which are linked to banks, any other individual including those operating Common Service Centres (CSCs); NGOs/ MFIs set up under Societies/ Trust Acts and Section 25 Companies; Cooperative Societies registered under Mutually Aided Cooperative Societies Acts/ Cooperative Societies Acts of States/Multi State Cooperative Societies Act; Post Offices; and Companies registered under the Indian Companies Act, 1956 with large and widespread retail outlets, excluding Non Banking Financial Companies (NBFCs).

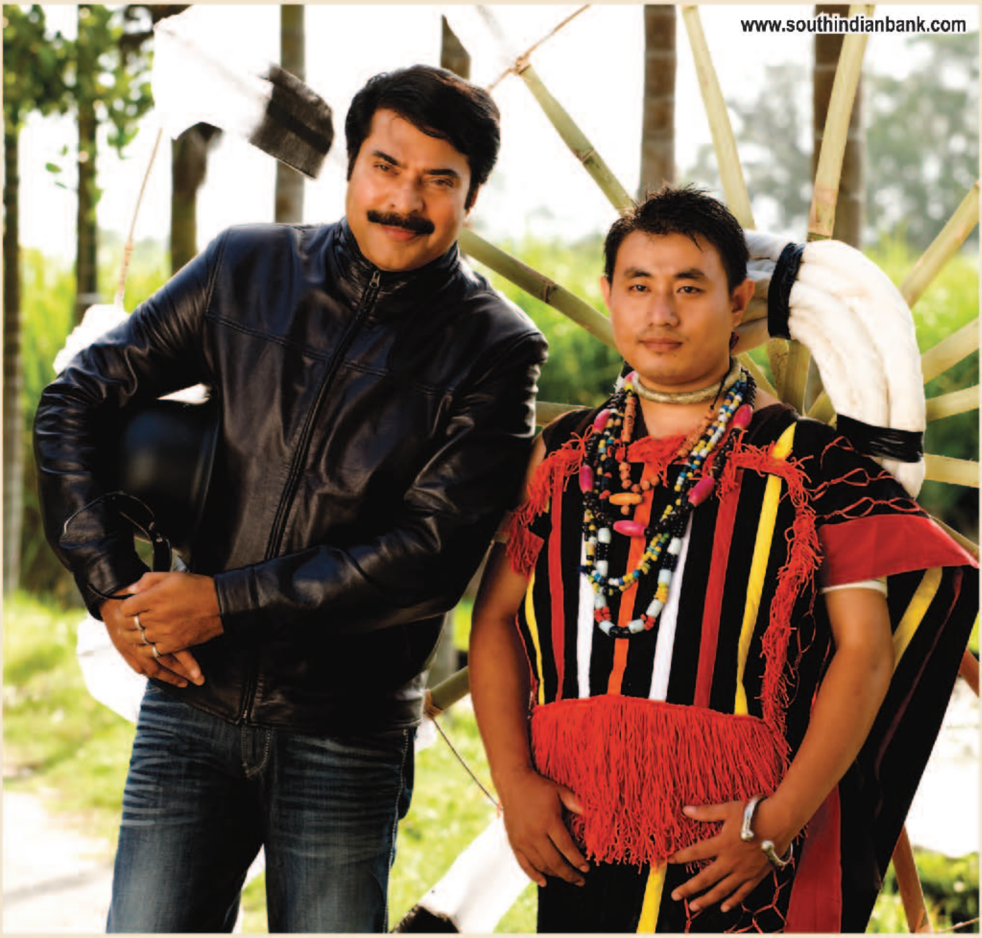
Scope of activities

The scope of activities of BCs include (i) identification of borrowers; (ii) collection and preliminary processing of loan applications including verification of primary information/data; (iii) creating awareness about savings and other products and education and advice on managing money and debt counseling; (iv) processing and submission of applications to banks; (v) promoting, nurturing and monitoring of Self Help Groups/ Joint Liability Groups/Credit Groups/others; (vi) post-sanction monitoring; (vii) follow-up for recovery, (viii) disbursal of small value credit, (ix) recovery of principal / collection of interest (x) collection of small value deposits (xi) sale of micro insurance/ mutual fund products/ pension products/ other third party products and (xii) receipt and delivery of small value remittances/ other payment instruments.

The distance between the place of business of a BC and the bank branch should ordinarily not exceed 30 kms in rural, semi-urban and urban areas and 5 kms in metropolitan centers. The banks may pay reasonable commission to the BC.

The transactions should normally be put through ICT devices (handheld device/ mobile phone) that are seamlessly integrated to the Core Banking Solution (CBS) of the bank.

Your comments and feedback on this publication may be sent to Staff Training College, The South Indian Bank Ltd., Thrissur 680 001 or by E.mail: ho2099@sib.co.in



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