

CHAPTER-6

ISSUES AND CHALLENGES OF FINANCIAL INCLUSION IN INDIA

Taking into account the achievements stated in the previous chapter and based on our interactions with the stakeholders during our various outreach programmes, as also the feedback received from our meetings with the frontline managers, the more important issues which need to be attended; are listed below:

Sr. No.	Issues	Remarks
1.	<p>Business Correspondents (BC)</p> <p>For effective functioning of BC model in reaching poor villagers, the following need to be addressed:</p> <ul style="list-style-type: none"> • BCs are not making enough income due to catering of services to low-income customers with low volume transactions. For optimum usage of BCs in reaching the poor villagers, BCs have to be adequately compensated so that they are sufficiently incentivized to promote financial inclusion as a viable business opportunity. • The usefulness of BC model is dependent on the kind of support provided by the bank branches. For effective supervision of BC operations and for addressing cash management issues as also to take care of customer grievances, banks should open small brick and mortar branches at a reasonable distance. • Further, banks should initiate suitable training and skill development programmes for effective functioning of BCs. 	Banks
2.	<p>Tailor Made Services</p> <ul style="list-style-type: none"> • Innovative Products: Designing suitable innovative products to cater to the requirements of poor villagers at affordable rates is an absolute imperative. 	Banks

	<ul style="list-style-type: none"> To wean away villagers from borrowing from money lenders, banks should develop simplified credit disbursement procedures and also flexibility in their work processes. 	
3.	<p>Technology Applications</p> <ul style="list-style-type: none"> In an ICT enabled environment, technology is the main lever to achieve the eventual goal of financial inclusion at the earliest. ATM-Network: ATM Network in rural areas accounted for only 10.1 per cent of total ATMs in the country as on March 31, 2013. Banks should enhance their ATM network in rural and un-banked areas to serve poor villagers. While doing so, adequate care should be taken regarding safety/ security issues, which have come to the fore in recent times. RuPay Network: To reduce the overall transaction costs associated with small ticket transactions in rural areas, domestic RuPay cards may be utilized. KCC/GCCs: To enable farmers to withdraw cash from ATMs anywhere in the country, banks need to convert KCCs/GCCs to electronic credit card. Further, banks may explore the possibility of issuing multipurpose cards which could function as debit cards, KCC and GCC as per the requirements in rural areas. Mobile Banking: In rural India, there are 323.27 million mobile subscribers as on March 2012 (TRAI Annual Report, 2012). To examine the options/ alternatives, including the feasibility of using encrypted SMS based funds transfer using an application that can run on any type of handset for expansion of mobile banking in the country, RBI constituted a committee 	<p>Banks/ RRBs, Co-op Banks</p> <p>Banks/ RRBs, Co-op Banks</p> <p>Banks/ RRBs</p>

	<p>(Chairman: B. Sambamurthy)</p> <ul style="list-style-type: none"> Technology Service Providers (TSPs): There are a numbers of issues involving TSPs vis-à-vis several banks. 	Banks
4.	<p>BSBD Accounts</p> <p>It is understood that nearly half of the BSBD accounts are dormant. For effective use of BSBD accounts economic activity needs to be improved.</p>	Governments -Central and State; Banks, Co-op Banks, RRBs
5.	<p>Use of Primary Agricultural Co-operative Societies (PACS) and Primary Cooperatives as BCs</p> <p>PACs penetration in rural areas is far more than that of bank branches. Banks may make use of this largest rural network of cooperatives as business correspondents.</p> <p>Recent NABARD circular also envisaged that PACS can be utilized as BCs for CCBs/SCBs.</p>	Banks, RRBs, State Governments
6.	<p>Financial Inclusion in Urban Areas</p> <p>Generally, urban financial inclusion leaves vast scope for improvement. Migration from rural to urban centres is also accentuating the problem.</p>	Banks
7.	<p>Remittance Corridors</p> <p>Remittance facility for migrant population is of paramount importance. Providing of easy and cheap remittance facilities to migrant population is an absolute imperative.</p>	Banks
8.	<p>Migrants are not Adequately Covered</p> <p>Migrants are facing difficulties in opening bank accounts. Commercial banks need to take care of the needs of the migrant population in their financial inclusion plans.</p>	RBI and Banks
9.	<p>Human Face of Banking</p> <p>To deal with poor villagers, banks need to initiate</p>	Banks

	training programmes to frontline staff and managers as well as BCs on the human side of banking.	
10.	<p>Agriculture Advances</p> <p>While the number of farmers accounts with SCBs' increased from just 63 lakh in March 2006 to 176 lakh in March 2010; in terms of credit, farmers with land holdings 'above 5 acre' accounted for largest share of 44% of total bank credit. To achieve meaningful financial inclusion, banks should give priority for small farmers as compared to large farmers while sanctioning credit.</p>	Banks
11.	<p>Scalability of CBS Platform</p> <p>In order to handle the growing amount of work due to intensive financial inclusion efforts of country, banks/RRBs should ensure scalability of their CBS platforms.</p>	Banks/ RRBs
12.	<p>Electronic Benefit Transfer (EBT)</p> <p>The EBT scheme being an important and integral part of the overall Financial Inclusion with its attendant benefits, banks should promote EBT systems effectively for boosting their financial inclusion plans.</p>	Banks
13.	<p>Ultra Small Branches</p> <p>Ultra Small Branches may be set up between the base branch and BCs to provide support to about 8-10 BC units at a reasonable distance</p>	New Private Banks/ RRBs
14.	<p>Low Credit Share of Rural Areas</p> <p>Although, in terms of number of branches, rural areas account for nearly 30 per cent of total branches of scheduled commercial banks, the share of rural credit account for less than 10 per cent of total credit. Govt./Banks should initiate steps to increase the credit absorption capacity in rural areas by promoting employment and other opportunities.</p>	Banks/GoI

15.	<p>Private Sector banks need to open more branches in rural areas: In the case of private sector banks, rural branches accounted for just 13.3 per cent of their total branches in March 2013 (while in the case of public sector the same stood at 33.1 per cent). There is an imperative need to ramp up the number of rural branches by the private sector banks</p>	Private Banks
16.	<p>Penetration of RRBs in Financially excluded Regions</p> <p>Though RRBs have more presence in central (30.7 per cent as on March 2012) and eastern regions (23.1 per cent), financial exclusion is more acute in these regions.</p>	RRBs
17.	<p>Infrastructure Development</p> <p>For up-scaling financial inclusion, adequate infrastructure such as digital and physical connectivity, uninterrupted power supply etc. are prerequisites. Reportedly, out of six lakh villages in India, around 80,000 villages have no electricity and the constraints of electricity directly impact the working of banks.</p>	Central & State Governments
18.	<p>Vernacular Languages</p> <p>Financial inclusion efforts should necessarily be done in vernacular languages. In this context, the need for vernacularisation of all forms (including legal forms) is an absolute must, at least in major languages. As per Akosha there are 10,506 consumer complaints received against financial sector (includes banking, finance, insurance, real estate and construction) during the period January 2013 to March 2013.</p> <p>As part of Financial Literacy initiatives, if banks were to undertake pro-active steps in helping the common public to get over their English phobia, it is felt that the number of complaints would increase manifold.</p>	Banks & Other FIs

19.	<p>Private Corporate Initiatives</p> <p>A few large private corporates have undertaken projects such as E-Choupal / E- Sagar (ITC), Hariyali Kisan Bazar (DCM), Project Shakti (HUL), etc. Reportedly, these pioneering projects have brought about vast improvement in the lives of the participants and set the tone for economic development in their command areas; which is a pre-requisite for Financial Inclusion efforts to be undertaken by the banking system.</p>	Private Corporates
20.	<p>Post-offices</p> <p>Post offices (POs) are closest to the rural people compared to bank branches. As on March 31, 2011, there are 1,54,866 post offices in India, of which 1,39,040 (89.8%) were in rural areas. All round efforts should be made to ensure that Post Offices play a greater and more active role due to known advantages. Progressively, more POs may be engaged to become BCs of banks due to well-known advantages.</p>	RBI and Government
21.	<p>White Label ATMs</p> <p>RBI has already started allowing eligible private entities to establish White Label ATMs. There is case for its acceleration.</p>	RBI, Private Corporates
22.	<p>MSME – Financial Exclusion</p> <p>The statistics based on 4th Census on MSME sector revealed that only 5.18 per cent of the units (both registered and un-registered) had availed finance through institutional sources, 2.05 per cent got finance from non-institutional sources. The majority of units i.e., 92.77 per cent had no finance or depended on self-finance. SIDBI should go into the reasons for not getting access to formal sources of credit by the majority of MSME units.</p>	SIDBI/ Banks

23.	<p>SHG-Bank Linkage-Penetration</p> <p>Although SHG-Bank Linkage model is successful in rural areas, it has not spread evenly throughout India, the spread is poor especially in the financially excluded regions namely central and north- eastern.</p>	NABARD
24.	<p>SHG-Bank Linkage Outstanding Bank Credit</p> <p>Outstanding bank loans against SHGs accounted for only 1.93 per cent of gross bank credit as on March 31, 2011. It was observed that SHGs were not getting loans from banks even after more than one year of its formation and group activities. Certain difficulties were being experienced by SHGs in obtaining bank credit which NABARD should look into and inform RBI of the same.</p>	NABARD
25.	<p>Insurance for Rural India</p> <p>Over 70 per cent of total population resides in the rural areas of the country. However, insurance reaches less than 3 per cent of the total population. Due to high competition and relatively high market saturation in the urban areas, rural areas provide ample business opportunities for insurance firms – both life and non-life.</p>	IRDA
26.	<p>Scope for Further Research</p> <p>In financial inclusion, there are a few potentially interesting areas for future research –viz., (a) the most appropriate delivery model (which banks are still trying to figure out) for different geographical regions given their unique characteristics, (b) The unbanked segments-beit in rural, urban or metropolitan areas are largely served by the un-organized sector even today. Research into the products, practices and procedures of this unorganized sectors an absolute imperative, to identify and understand the same which the bottom of the pyramid populace finds so convenient and comfortable to deal</p>	Research Agencies

	<p>with. This could throw up valuable leads for the organized sector—banks and financial institutions to follow (c) Further, in order to measure the intensity of money lenders especially in rural areas, research agencies should, inter alia, conduct a census of money lenders in rural India.</p>	
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Addressing financial exclusion requires huge effort and resources, thereby taking a longer time to address these imbalances. Economist assumes that human beings as rational and so would respond to a policy like a rational person. However, Behavioral Science has proved that this has not been the case and humans are shown to be irrational at most times. The behavioral economic experts believe that simple changes can lead to more financial inclusion.

Several challenges like large area, cost of small value transactions, weak delivery model, unsuitable products, infrastructure, lack of finances, management support have to be effectively dealt with. The automation of core banking processes with the use of channels such as ATM, IVR based Tele-banking, Internet banking, the banking industry has become more profitable. Banks however, face an uphill task of reaching out to the mass customers in remote areas such as villages. Naxal Movement, low Return-on-Investment (ROI), customer behavior, operating expenses inhibits banks from expansion in rural areas.

Although the Banking Correspondent Model has experienced some success, there have been several hurdles and challenges. We have looked at some of the challenges in terms of different factors. They are:

Cash handling

Allowing BCs to handle cash is the biggest challenge. Ninety-nine percent of the financial transactions are in cash, warranting high-cost cash-handling operations and added operational risks. Moreover, clients tend to perceive that the BCs are the owners of the transactions and not facilitating them on the banks’ behalf.

Gullible client profile

Recipients of BC services are mostly illiterate and unfamiliar with technology rendering them susceptible to misguidance by the BCs.

Fraud & Misappropriation

Since the BCs' staff operates individually without any line supervision, the risk of fraud and misappropriation is higher. There have been instances noted of miscommunication by BCs. Failure to account for cash and falsification of records have been noticed and dealt with by banks.

Technological barriers

Technology is an issue because of lack of standards and training and maintenance. A technology framework should encompass policy, legal, security, transaction framework and facilitate greater coverage. Absence of appropriate technology is a challenge. Transaction costs are too high because technology is not leveraged fully. Finger print storage and retrieval need to be made convenient. Methodology and standards for data storage on cards also needs to be addressed.

Demand side barriers

Demand side barriers include lack of financial literacy, lack of awareness of financial services and products, social exclusion and the fact that certain products being currently offered are not suitable for the poor.

Supply side barriers

Supply side barriers are the issues with high transaction costs, lack of communication and the lack of a proper framework or infrastructure.

Agency risk

Clients perceive the banking correspondents as the owners of the transactions. If something goes wrong, the blame would all be on the BC. Reputation risk also of concern since the reputation and credibility of the system is vital for its success. There is a lack of ownership among the banks and lack of participative involvement of banks.

Interest capping

Reaching unbanked areas warrants higher delivery costs and the rate cap doesn't allow much room for banks to recover the costs necessary to extend credit to hard-to-reach areas and in small amounts.

Distance criteria

Banks do not always find it easy to get service area waivers from District-level Committees which are necessary to operate in certain areas. A number of requests are pending for approval and many requests have been rejected without any explanation.

Cash settlement

Current regulations mandate BCs to complete accounting and settle cash with bank branches within 24 hours of transaction. Given the area of operation of BCs - rural areas with accessibility issues - making settlements within a prescribed timeframe have become a challenge.

Behavioral Issues

Face to face interaction with many of rural respondents regarding access to, requirement of, problem and challenges put before us the following problems they face at the back of mind while thinking of the financial services. If these factors are given equal weight in policy making and planning, they might get into the stream of Inclusion.

Problem of Choice

There are different variants of the simple financial products that a uneducated rural customer is not able to differentiate and he found that this large number of variety is not designed to meet the specific requirements but to make the trap of them and plough back large amount of money. When you go for opening a Bank account and are asked to select the Debit card option (One is general ATM, other is easy shop card/VISA/ Master card) many of us do not click on any of them as we don't know which is the best choice. But bank provides default card, depending on the account type and customer is given bare minimum service without request. Hence, it is better to include a default product amidst various options, with default being the choice that leads to a better choice. The default

means if the consumer is unable to choose, the default option will be applicable. In such cases he often needs to request for the service closer.

Complex Procedures

It has been seen in experiments that people who do not avail financial services vis-à-vis financial service user are reluctant to go service provider as they are not clear of the directions, processes etc. Another important finding is that poor people avoid banks because of complicated forms, procedures etc. Simpler structures will lead to higher footfalls to the banks. There is an opportunity for the financial services to offer the services in the regional languages. Most of the institutional paper work is done in English to which most of rural masses is not aware of. They present the idea of having pay-in slip in Hindi on one side and English on the other part. Writing same statement in two languages causes mis-understanding and several times they are very much confused.

Wealthy Image

People want to keep a low profile and thus not approach banks as that would send signal to the community that they have some money to spare. Another reason behind this was found that in case they were found wealthy they will not be entitled with the benefit of Public distribution services. With view of developing new structure of economic reservation people are less reluctant to disclose their finances.

Default Risk

People often prefer to go for informal credit facility because they fear out that in case they are late in making repayment they will simply get extended period without any difficulty and harm on social image but this can be damaging in case of formal credit payments. Also, they believe that when they can invest their saving for high rate of interest (20-25 per cent per annum) there is no harm in taking credit for the same rate. Although Bank and other financial institution provide loan at low rates they need to design the appropriate repayment plan and business need to be more controlled and privacy of customer should be focused.

Stereotyping

It has been found that people generally compare financial products available for them with the urban counterpart. Some of them said that their son account was deducted like this or that when he was studying in city. They perceive the service with the experience of few or even individual. Also, they can easily compare insurance company claim settlement with bank fixed deposit payment. This need to be corrected and also institutions need to focus on the quality of the services.

Law and Order

The rural may not be approaching banks for the fear of being looted on the way. In the rural areas crimes are common and one has to be careful with the monies. So, may be financial inclusion will pick up if we address law and order problem.

Gender Differences

Research shows that women are better savers than men and financial inclusion is more likely to succeed with them in the fold. However, in rural areas women are not allowed to move around and their movement is limited to areas around the house.

Financial Exclusion

It has been found that financial services are used only by a section of the population. There is demand for these services but it has not been provided. The excluded regions are rural, poor regions and also those living in harsh climatic conditions where it is difficult to provide these financial services. The excluded population then has to rely on informal sector (moneylenders etc) for availing finance that is usually at exorbitant rates. These lead to a vicious cycle. First, high cost of finance implies that first poor person has to earn much more than someone who has access to lower cost finance. Second, the major portion of the earnings is paid to the moneylender and the person can never come out of the poverty.

High cost

It has also been seen that poor living in urban areas don't utilize the financial services as they find financial services are costly and thus are unaffordable. Hence, even if financial services are available, the high costs deter the poor from accessing them. For

example, to open a checking account in Cameroon, the minimum deposit requirement is over 700 dollars, an amount higher than the average GDP per capita of that country, while no minimum amounts are required in South Africa. Annual fees to maintain a checking account exceed 25 percent of GDP per capita in Sierra Leone, while there are no such fees in the Philippines. In Bangladesh, Pakistan, Philippines, to get a small business loan processed requires more than a month, while the wait is only a day in Denmark. The fees for transferring 250 dollars internationally are 50 dollars in the Dominican Republic, but only 30 cents in Belgium.

Non-price barriers

Access to formal financial services also requires documents of proof regarding a persons' identity, income etc. The poor people do not have these documents and thus are excluded from these services. They may also subscribe to the services initially but may not use them as actively as others because of high distance between the bank and residence, poor infrastructure etc.

Behavioral aspects

Research in behavioral economics has shown that many people are not comfortable using formal financial services. The reasons are difficulty in understanding language, various documents and conditions that come with financial services etc.

Lack of information

There is lack of information about the role and function of banks, banking services, products, and interest rates, etc. stop people from including themselves in mainstream banking.

Insufficient documentation

Many people (even in metropolis and urban areas) are unable to show their self identification documents during the opening of a bank account or during taking a loan.

Lack of awareness

Many people are unaware of the banking terms and conditions laid down from time to time.

High transaction charges

Various commercial banks across the globe levy transaction charges on credit or debit transactions, on over usage of banking services, on cheque book issuance etc.

Lack of access

Accessibility is a problem from all those people who live in geopolitically isolated regions.

Moreover, as most of the commercial banks are located in the vicinity of cities, people in rural areas (mainly in developing countries) have a geographical barrier in accessing banks.

Illiteracy

Because of illiteracy, a substantial number of people are unable to take recourse to banking services.