

Role of Private Sector Banks in Financial Inclusion - Issues & Challenges W.

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ABSTRACT

The article explores the geographical distribution of private sector banks in India and its impact on financial inclusion and Challenges. At the end of March 2012, 50.8 million no frills account were opened by the banking system. The banks have a challenge to keep these accounts operational. Banks were advised to provide small overdraft in these accounts, and up to March 2011 banks provided overdraft of Rs. 30.54 crore. No frills account provides the opportunity for a common man to open bank account. These accounts have no pre condition and low minimum balance maintenance. RBI initiated scheme of no frills account in 2005 to improve financial inclusion and now RBI taken necessary steps to develop the new bank branches to all rural area.

1. INTRODUCTION

Importance of financial inclusion arises from the problem of financial exclusion of nearly 3.5 billion people from the formal financial services across the world. The review of literature suggests that the most operational definitions are context-specific, originating from country-specific problems of financial exclusion and socio-economic conditions. Thus, the context-specific dimensions of financial exclusion assume importance from the public policy perspective. The operational definitions of financial inclusion, have also evolved from the underlying public policy concerns that many people, particularly those living on low income, cannot access mainstream financial products such as bank accounts and low cost loans, which, in turn, imposes real costs on them -often the most vulnerable people (H.M. Treasury, 2007). Thus, over the years, several definitions of financial inclusion/exclusion have evolved. In the Indian context, Rangarajan Committee (Report of the Committee on Financial Inclusion in India (2008)). Defines it as: "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." The financial services include the entire gamut - savings, loans, insurance, credit, payments etc. By providing these services, the aim is to help them come out of poverty.

2. OBJECTIVE OF THE STUDY

- The objective of the study is to know the role of private and public sector banks and RBI in developing financial inclusion to all excluded sections of the society, metropolitan, rural and urban areas.
- To study the emerging challenges of commercial bankers.

3. METHODOLOGY OF THE STUDY

The study based on the secondary data which is collected from RBI website and other national and international journals. The data used for analysis till March 2012, the article examines private sector banks contribution and role towards rural urban semi urban and metropolitan and their role.

FINANCIAL INCLUSION AND INCLUSIVE GROWTH IN INDIA

From an annual average growth rate of 3.5 per cent during 1950 to 1980, the growth rate of the Indian economy accelerated to around 6.0 per cent in the 1980s and 1990s. In the last four years (2003-04 to 2006-07), the Indian economy grew by 8.8 per cent. In 2006-07 and 2008-12, the Indian economy grew at a higher rate of 9.4 and 9.6 per cent, respectively. Reflecting the high economic growth and a moderation in population growth rate, the per capita income of the country also increased substantially in the recent years. Despite the impressive numbers, growth has failed to be sufficiently inclusive, particularly after the mid-1990s. Agricultural sector which provides employment to around 60 per cent of the population lost its growth momentum from that point, though there has been a reversal of this trend since 2005-06. The percentage of India's population below the poverty line has declined from 36 per cent in 1993-94 to 26 per cent in 1999-2000. While India has witnessed unprecedented economic growth in recent past, its development has been lopsided with the country trailing on essential social and environmental parameters of development. The approach paper to the Eleventh Plan indicated that the absolute number of poor is estimated to be approximately 300 million in 2004-05. Accordingly, the 11th Five Year Plan has adopted "faster and more Inclusive growth" as the key development paradigm. The importance of this study lies in the fact that India being a socialist, democratic republic, it is imperative on the policies of the government to ensure equitable growth of all sections of the economy. With only 34% of population engaged in formal banking, India has, 135 million financially excluded households the second highest number after China. Further, the real rate of financial inclusion in India is also very low and about 40% of the bank account holders use their accounts not even once a month. It is universally opined that the resource poor need financial assistance at reasonable costs and that too with uninterrupted pace. However, the economic liberalization policies have always tempted the financial institutions to look for more and more greener pastures of business ignoring the weaker sections of the society. In India, the financially excluded sections comprise largely rural masses comprising marginal farmers, landless laborers, oral lessees, self-employed and unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women.

Some of the important causes of relatively low extension of institutional credit in the rural areas are risk perception, cost of its assessment and management, lack of rural infrastructure, and vast geographical spread of the rural areas with more than half a million villages, some sparsely populated (Mohan, 2006). It is essential for any economy to aim at inclusive growth involving each and every citizen in the economic development progression. It is in this context that financial inclusion should be aimed at inclusive growth in the Indian context. Select macro-economic and financial indicators of Indian economy are presented here

ISSUES AND CHALLENGES

India currently faces several issues and challenges in the area of Financial Inclusion for Inclusive growth. Salient among them are stated here below:

SPATIAL DISTRIBUTION OF BANKING SERVICES

Even though after often emphasized policy intervention by the government and the concerted efforts of Reserve Bank of India and the public sector banks there has been a significant increase in the number of bank offices in the rural areas; but it is not in tune with the large population living in the rural areas. For a population of 70% only 45% of bank offices provide the financial services.

REGIONAL DISTRIBUTION OF BANKING SERVICES

The analysis by the authors brings to the fore that there has been uneven distribution of the banking services in terms of population coverage per bank office in the six regions viz; Northern, North-eastern, Eastern, Central, Western and Southern regions of the country.

BANK BRANCHES

Bank branches are required to be increased as it has a direct impact on the progress of financial inclusion. It is clearly established that as the bank branches increase number of bank accounts also increase significantly.

POVERTY LEVELS

Poverty levels are having direct relationship with the progress of financial inclusion. The authors have established in their study that as the poverty levels decrease financial inclusion also increase. As such, there should be multi fold strategic approach in such poverty dominated areas for financial inclusion.

SC/ST POPULATION

It is ascertained by the authors' study that in the areas of Scheduled Castes/Scheduled Tribes population the progress of Financial Inclusion is slow which indicates that the efforts for Financial Inclusion has to be increased significantly in such areas in order to bring in social and economic equity in the society.

OVERCOMING BANKERS' AVERSION FOR FINANCIAL INCLUSION

Even though no banker openly expresses his aversion for the financial inclusion process, overtly it can be noticed that they are averse to it in view of the cost aspects involved in opening of no frill accounts.

INDIAN BANKING SYSTEM

Indian banking system has emerged as a vibrant sector in the Indian economy. Strong regulatory mechanism, inherent strength in the economy, and progressive policy framework which supports, nurtures, and helps in growing the financial institutions. There has been

amazing growth in profits in our banking industry over the last two decades. The banking sector index has grown at a compounded annual rate of 51% since the year 2001. Many of the private sector banks had significant exposure to global financial world. Due to the global exposure private banks were

adversely affected during recession. Timely interventions by RBI made it easier for banks to overcome the adverse impacts of recession. Indian banking system remained resilient during the recession. It was due to conservative approach of banks, cost cutting measures, and following the guidelines of RBI. RBI reduced statutory liquidity ratio (SLR), cash reserve ratio (CRR), Repo rate, and Reverse repo rate to increase the money supply to ease the tight liquidity position. No single bank needed government bailout during recession. Private sector banks pioneered the use of technology to provide enhanced customer services. Anywhere and anytime banking became a reality. The widespread application of internet banking had made it possible to market financial products and services on a global basis. Despite the sound and robust banking system, there are certain challenges. Indian banking is too fragmented as compared to global standards. To compete globally Indian banks need to scale up the size of their operations.

Initiatives for financial inclusion in India The broad strategy for financial inclusion in India in recent years comprises the following elements: (i) encouraging penetration into unbanked and backward areas and encouraging agents and intermediaries such as NGOs, MFIs, CSOs and business correspondents (BCs); (ii) focusing on a decentralized strategy by using existing arrangements such as State Level Bankers' Committee (SLBC) and district consultative committee (DCC) and strengthening local institutions such as cooperatives and RRBs; (iii) using technology for furthering financial inclusion; (iv) advising banks to open a basic banking 'no frills' account; (v) emphasis on financial literacy and credit counseling; and (vii) creating synergies between the formal and informal segments.

RBI'S FINANCIAL INSERTION FORCE

No-Frills Accounts (NFAs): In the year 2005, the RBI, in its annual policy statement expressed the concerns of banking policies and practices that "tend to exclude rather than attract vast sections of the population". The RBI urged banks to review their existing practices to align with the objective of financial inclusion by providing all "unbanked" households in a district, with savings account by opening "no-frills" account (NFAs) with nil or very low minimum balance. While opening such bank accounts, banks are asked to relax their Know Your Customer (KYC) norms for individuals who do not foresee having more than Rs. 50,000 in all their combined accounts and whose annual total borrowing will not exceed more than Rs. 100,000. In addition, the RBI also announced a targeted drive for financial inclusion throughout the country, wherein each household would receive one 'no frills' bank account.

A study by CMF-IFMR. Found that in Cuddalore, Tamil Nadu, 25% of households remained excluded even after full inclusion was declared. The study also found that 72% of the accounts had zero or near zero balance even after a year. Likewise, another CMF-IFMR study reports that the 100% inclusion drive in Gulbarga district, Karnataka did not have any major impacts on excluded households as one-third of the households were without bank accounts even after the drive. Nevertheless, the RBI has continued its efforts of financial inclusion. At the end of the year 2010-2012, 74.9 million NFAs had been opened by the banking system with the outstanding savings balance in these accounts being Rs 66.6 billion. It is also reported that

banks opened 4.2 million overdraft accounts in select NFAs. However, there is still a big question on whether these accounts are actively used by account holders as the number of NFAs is taken to be an indicator of the extent of a bank's commitment to the inclusion plan, rather than usage of the accounts themselves. A study conducted by CMF-IFMR in Gulbarga found that, as observed in the Cuddalore study as

well, 68% households had opened NFAs to receive MGNREGS wages. Likewise, in Andhra Pradesh, CMF-IFMR study found that 79% of accounts were opened either to receive government benefits (such as MGNREGS) or to increase the chances of receiving a loan. Another study conducted by CMF-IFMR found that the low usage of NFAs is due to narrow scope of NFAs such as caps on maximum balance, limited numbers of transactions in a month etc. The study suggests that services offered under NFAs should be broadened to improve their usability.

GENERAL PURPOSE CREDIT CARDS (GCC) AND KISAN CREDIT CARDS (KCC)

The RBI has advised all Scheduled Commercial Banks (SCBs), including Regional Rural banks (RRBs) to provide General purpose Credit Card facility at their rural and semi-urban branches. The credit card is provided based on the assessment of income and cash flow of the household similar to that prevailing under normal credit cards²¹. Likewise, the RBI has also introduced Kisan Credit Cards scheme to provide "adequate and timely credit support from the banking system under a single window to the farmers for their cultivation and other needs." As on March 2012, almost 22.50 millions farmers are provided with Kisan Credit Cards and 950,000 clients are provided with General Purpose Credit Cards²⁴.

BUSINESS FACILITATORS (BFS) AND BUSINESS CORRESPONDENTS (BCS)

In order to ensure greater financial inclusion and increase the outreach of the banking sector, the RBI has proposed that banks use the services of NGOs/SHGs, MFIs and other civil societies (excluding NBFCs) as intermediaries in providing financial and banking services through the usage of Business Facilitators and Business Correspondents. The Business Correspondents are permitted to carry out transactions on behalf of the banks as agents. The Business Facilitators can refer clients, pursue the clients' proposals and facilitate banks to carry out their transactions²⁶. The Business Correspondents can offer savings, credit, insurance and remittance services depending on the location and infrastructure. Today, a number of organizations such as Financial Information Network & Operations (FINO), EKO India Financial Services, and Zero Mass Foundation have begun working as BCs. By the year 2012, FINO and Zero Mass Foundation have reportedly linked 30 million and 8 million customers respectively with the banking system.

CMF-IFMR conducted a study to understand if the Business Correspondents model is financially viable at the level of each stakeholder, and found that the agents are struggling to make their business profitable and financially sustainable as the current commission structure is not adequate to cover agents' costs. In addition, the study reports that agents are facing issues with cash management and liquidity due to unwillingness to share risks by both BCs and banks. The study concludes that the BC model has an immense potential in promoting financial inclusion in India, and thus more efforts have been made to promote the model among the agents and prospective clients.

GLOBAL EXPERIENCES

While in developed countries, the formal financial sector comprising mainly the banking system serves most of the population, in developing countries, a large segment of the society, mainly the low-income group, has little access to financial services, either formal or semi formal. As a result, many people have to necessarily depend either on their own sources or informal sources of finance, which are generally at high cost. Most of the population in developed countries (99 per cent in

Denmark, 96 per cent in Germany, 91 per cent in the USA and 96 per cent in France) has bank accounts (Peachy and Roe, 2004). However, formal financial sectors in most developing countries serve relatively a small segment, often no more than 20-30 per cent of the population, the vast majority of who are low income households in rural areas (ADB, 2007). Recent data (Table-1 in Annexure-1) shows that countries with large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. Typically, countries with low levels of income inequality tend to have lower levels of financial exclusion, while high levels of exclusion are associated with the least equal ones. In Sweden, for example, lower than two per cent of adults did not have an account in 2000 and in Germany, the figure was around three per cent (Kempson, 2006). In comparison, less than four per cent of adults in Canada and five per cent in Belgium lacked a bank account (Buckland et al, 2005). Countries with high levels of inequality record higher levels of banking exclusion. To illustrate, in Portugal, about 17 per cent of the adult population had no account of any kind in 2000 (Kempson, 2006).

GEOGRAPHICAL DISTRIBUTION

The private banks started from the metropolitan cities. After growth in metros, the private sector banks are expanding their network into urban, semi urban, and rural areas. Table shows the network spread of private banks in different types of population group. Private Banks are not just concentrated in metros but they have started making inroads into the rural market as well. The semi urban areas have benefitted significantly from the presence of private sector banks. 30% of the branches of private banks are in semi urban areas.

Initially private bank branches were concentrated in the southern and western states. But the trend of new branches indicates that there is increase in branches in other regions also like Uttar Pradesh added 265 more branches over 91 old branches, Rajasthan added 141 new branches, Madhya Pradesh 117, Assam 46. The enhanced standard of governance in Bihar is also reflecting in terms of growth in number of branches. Bihar added 40 new branches.

POPULATION GROUP WISE DISTRIBUTION OF OFFICES OPENED OR CLOSED BY COMMERCIAL BANKS-2011 AND 2012

From the above table clear that private sector banks have opened distribution office in rural area for developmental aspects, as on 31st march 2011 in Rural 1312, semi urban 3843, urban 3406, metro 3484 totally 12045 less than public sector banks (Total Public sector distribution office is 65416).

As on March 31st newly opened in rural 0, semi urban 0, urban 1, metro 1 totally 2 (public sector is 40) for the purpose of linking them to bank transaction. So it is clear that private sectors took initiation to open new distribution office in rural areas.

Population group-wise distribution of offices opened as on March 31st 2012 by private sector bank in Rural 1582, Semi urban 4716, Urban 3722, Metropolitan 3848, Totally 13868 and newly opened in Rural 270, Semi urban 874, Urban 317, Metropolitan 368, Totally 1829, and 4 offices were merged with public sector company. It is indicated that based on the population in the country the private sector bankers extended their services.

From the above analysis North region has centers 5447 and 17987 offices which include Chandigarh, Delhi, Haryana, Himachal Pradesh, Jammu & Kashmir, Punjab and Rajasthan. The North Eastern Region has 1280 centers 2562 offices which include Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura. The Eastern Region has 8063 and 16434 offices which includes Andaman & Nicobar, Bihar, Jharkhand, Orissa, Sikkim, and West Bengal. The Central Region has 8572 centers and 20014 offices which includes Chhattisgarh, Madhya Pradesh, Uttarakhand and Uttar Pradesh. The Western region has 4482 centers and 15790 offices which include Dadra & Nagar Haveli, Daman & Diu, Goa, Gujarat and Maharashtra. The Southern Region has 2329 centers and 7670 offices which include Andhra Pradesh, Karnataka, Kerala, Lakshadweep, Puducherry and Tamil Nadu.

The North Eastern region which having seven states has less distribution centers and office. Central region having more distribution centre and offices with four states which indicate that other region also financial inclusion services can extend more.

4. CONCLUSION

The private bankers are providing their services in all the population groups. They have started expansion plans in semi urban and rural areas. This is a good sign for ensuring financial inclusion and better quality of service in these areas. The information and communication technology offers the opportunity for the private and commercial bankers to improve financial inclusion for the unbanked people.

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