PAHLE INDIA FOUNDATION

PUTTING INDIA FIRST TO MAKE INDIA FIRST

Discussion Paper

ALTERNATIVE BANKING MODELS FOR FINANCIAL INCLUSION

By

Saurabh Roy

March 2016

PIF/2016/FERU/DP/02

ALTERNATIVE BANKING MODELS FOR FINANCIAL

Saurabh Roy

saurabh.roy@pahleindia.org

PIF/2016/FERU/DP/02

March 2016

Abstract

There is ample evidence to suggest that financial inclusion leads to greater economic growth and helps raise people's standard of living and income [1]. Microfinance or the provision of financial services to poor people such as money transfers, loans, savings and insurance has been at the center of poverty alleviation and development efforts as was popularized by Mohamed Yunus and Grameen Bank. Financial inclusion has always been an important goal for policy makers and there have been many forays and experiments into what would be the best way to take banking to the under-banked in developed as well as less developed countries. Market failures such as adverse selection provide the main justification for intervention in markets [Stigliz, 1981]. Despite sound rationale and intentions, government interventions have been plagued by inefficiency and mismanagement.

From micro-finance to bitcoins, the world has seen many forays into providing banking services to the under-banked; some more successful than others. In this brief, we look at some of the models that have worked to varying degrees of success in the world. With technology making huge strides in making the world a more efficient place, several new models may crop up like Fidor Bank or possibly payments banks in India. These models are in no way comprehensive and many more alternative models have been very successful. We have just picked a few out of the hat to find ways in which banking can be expanded to the poor and unreachable in India.

Contents

1. Introduction

For the better part of the 20th century, financial inclusion implied access to credit and the world governments and NGOs focused on providing access to credit to the unbanked. However, the financial requirements of the poor are as complex as those of the rich. They require access to credit to smoothen consumption, access to banking for savings, investments, and insurance and pension products for future requirements too. The main barriers to providing these services is the high cost of reaching the people. Most no-frills accounts are low balance accounts which makes maintaining and servicing such accounts unprofitable for banks. From an access to credit perspective, lack of collateral and high transaction cost restrict penetration. When such barriers do not exist; a lack of awareness, limited financial literacy and access restrict up-take of financial services.

Micro-finance is not a new phenomenon. It has been discussed since the 1800s as a concept; Friedrich Wilhelm Raiffeisen´s village bank movement in Germany started in 1864 and by the year 1901 had reached 2 mn rural farmers. Micro-finance started having a major impact after the Marshall plan at the end of World War 2. Current understanding of microfinance originates in 1970s with institutions like the Grameen Bank. Even after a long history, microfinance falls under the ambit of alternative banking.

Alternative banking channels can be divided by the way services are provided: direct location based, direct remotely or indirect. The excitement around alternative banking is due to the promise of two possible breakthroughs. Firstly, some channels may offer the possibility of massive outreach to people who are underserved especially in remote locations. Secondly, it may offer a major reduction in costs by reducing fixed asset investment mainly by leveraging information and communication technology.

India has declared financial inclusion as one of its primary policy objectives as evidenced by the launch of the PMJDY. Which provides subscribers with a no-frills account along with life and health insurance. To enable further outreach, KYC norms are being eased by the use of a unique identification the Aadhar Card. Until recently, the RBI did not permit MFIs such as SKS or Bandhan to operate as banking correspondents of large banks or to leverage their own network of banking agents. However, change is at hand with the issuance of a full banking license to Bandhan microfinance and with payment banks being established. The RBI has also adjusted its guidelines on prepaid instruments that prevented these organizations from issuing cards. Similarly there is hope for greater clarity on telecom access for banking and financial services that could enable mobile money services like m-pesa and airtel money to take off.

1.1 Challenges

Financial Inclusion faces challenges in a methods acceptances because the customers are generally low-income, uneducated and are unfamiliar with financial products. This is of importance as currently a lot of push is on technological solutions to the outreach problem which the target customer base may be uncomfortable using. Tactics to increase adoption that have so far been successful are to offer a single compelling reason for adoption rather than provide a comprehensive solution from the start and familiarity. An example of the former is m-pesa which started with one single message “to securely send money”. After the initial uptake of the services, safaricom has been able to introduce value added services which offer the possibility of savings, loans and insurance. Alternatively, financial literacy can also promote uptake for products but it alone can’t change behavior from reluctance and fear to eager adoption of a product.

The emerging nature of alternative channels makes it difficult to forecast their viability. However, the economic justification of new channels usually rest on high volume of transactions. The technology required to set up POS and back end transaction handling that minimizes cost in the long term involves a high initial fixed investment. This is a major barrier for most channels not backed by a bigger company with a huge balance sheet.

Forced financial inclusion via credit has a checkered history with most government push towards inclusion leading to excesses and eventual failure. The US sub-prime crisis and India’s microfinance story should serve as a cautionary tale. While access to financial services is a worthy goal, prudence should be exercised when it comes to credit.

1.2 Alternative Experiments

Many countries have tried their own experiments on financial inclusion and promoted one or more channels of alternative banking over the past century. We looked at some of the success stories that worked and may have learnings for future policy.

2. KENYA: Digital Path to Financial Inclusion

2.1 Safaricom

Kenya is touted as one of the success stories of digital financial inclusion with m-pesa and Safaricom its poster-children. In Kenya, 21% of the people have a bank account, compared to 76% of the people with a mobile money account [2]. Safaricom has been able to provide a secure payment mechanism to millions of users in a country where safety of cash was an issue. It has also been able to reach far flung corners of the country via an agent network which provides liquidity to the m-pesa system. More recently, Safaricom has been able to build on this success to provide value added banking services to its customers via m-shwari (savings and loan), m-kesho (alternative bank account) and "lipa-na" m-pesa (merchant payment network).

To access m-pesa, customers register at an authorized outlet where they are assigned an individual electronic money account that is linked to their phone number and accessible through a sim card application on the mobile phone. Customers can then deposit and withdraw cash from their accounts by exchanging cash for electronic value at a network of retail stores or agents. These stores are paid a fee by Safaricom for every transaction. Once customers have money in their accounts, they can use their phones to transfer funds to other m-pesa users and even to non-registered users, pay bills, and purchase mobile airtime credit.

Safaricom is the dominant player in the Kenyan mobile market with an 80% market share while other players in other countries with similar market share have tried but have been unsuccessful to replicate safaricom. M-pesa was originally designed as a system to allow micro-loan repayments to be done by phone reducing the cost associated with handling cash but after a pilot study, it was broadened into a money transfer scheme. M-pesa's most important proposition was to transfer funds cheaper than other means.

The success and penetration of m-pesa is built on an enabling and experimental regulatory environment where Safaricom was supported in its endeavor by The Central Bank of Kenya. Safaricom was also able to leverage its pre-existing mobile tower network, which required no setting-up cost and its existing agent network, which was already providing recharge facilities. Cash is the major barrier to financial inclusion. As long as poor people can only exchange value in cash or physical goods, they will remain too costly for formal financial institutions to address in *significant numbers*. M-pesa's success is still a work in progress. It in itself does not constitute financial inclusion but gives a glimpse of what a commercially sound and affordable way to offer financial services to the poor could look like.

3. NIGERIA: From Rural to Community Banks

3.1 Rural Banks

Nigeria has experimented with various models of banks to improve banking penetration. In 1997, the Central Bank instituted a rural banking scheme. Even though the target of 1 bank branch per local government unit was met, the branches failed to expand rural credit and were mainly deposit takers.

3.2 The People's Bank

The People's Bank was set up in 1989 to meet the credit needs of the rural and urban poor, artisans, farmers, traders, etc. However, because it was supply-led and heavily dependent on subventions from the Federal Government for its operations, the recovery of loans was not very efficient and it is facing problems of decapitalization due to heavy overheads that outstrip earnings.

3.3 The Community Bank

Community Bank was conceived as a self-sustaining financial institution owned and managed by a community or group of communities for the purpose of providing credit, deposit banking and other financial services to its members largely on the basis of their mutual group responsibility, self-recognition and merit. This was supposed to replace RoSCAs which are quite popular in Africa.

The Bank was designed and modified to meet the needs of the small-scale entrepreneur who dominate the informal sector where many economic activities are carried out within a largely peasant mode of production. The National Board for Community Banks (NBCB), in 1992, was charged with the responsibility of promoting, developing, monitoring, and generally supervising the CBs. The primary objective of any CB was to mobilize funds for deposit and disbursement as loans and advances to members of the community. They also provide trade development advisory information services.

The CBs, as unit banks owned by individual communities, have succeeded in serving as a credit mobilization and provision mechanism to a people were marginalized by modem banking. With the de-emphasis on assets, collateral and security, and the promotion of trust, character witnessing and social mobilization, people at the grassroots have been brought into the ambit of wealth creation directed at improving the quality of lives and ultimately creating the bedrock for more sustainable development. Petty traders, hawkers, artisans and small scale processors have benefited from the CBs and several hitherto insignificant businesses have been turned around resulting in improved living standard for individuals, families and even whole communities.

3.4 Microfinance Banks

In 2007, The Central Bank of Nigeria under a new policy converted existing Community Banks in Nigeria into Microfinance Banks. Under the new policy, Micro Finance Bank were licensed to operate as a unit bank and operate and open branches within a specified local government area. Unlike the community banking policy framework which compulsorily confined all community banks to unit banking, the microfinance banking guideline permitted the branching of microfinance banks within a state. For the microfinance banks intending to open branches within a state their paid-up capital was put at N1 billion. Another point of divergence between the community banks and their microfinance successors was in the regulatory guidelines of who were allowed to own them. In addition to individuals, group of individuals, community development associations, private corporate entities which could own community banks, foreign investors and commercial banks, foreign investors could also own microfinance banks.

3.5 New Developments

Nigeria has rolled out an electronic national identity card that doubles as a prepaid card and can be used to make payments, opening up access to secure financial inclusion for millions of its citizens (2014). The card removes a major barrier in financial inclusion, i.e. proof of identity. By offering electronic identity coupled with prepaid capabilities, Nigeria can use this card to instill habit-forming financial behaviors and actively boost trust in mainstream financial services.

4. BRAZIL: Agents, Post and Microfinance

4.1 Agent Banking

Brazil is a well-documented advocate of agent banking, using post offices, lottery outlets and retail vendors to reach poor clients in rural areas. With lower operating costs, these trusted outlets process everything from money transfers to bill payments, deposits and withdrawals and even account applications, usually using point of sale terminals or personal computers that link to banks' servers. Seventy percent of households in the country pay at least one bill using agent banking, according to a 2013 survey by the Bankable Frontier Associates and the Bill & Melinda Gates Foundation.

All the major banks utilize the services of agents like Caxia, Banco do Brasil, Bradesco, HSBC, Santander and others. Agents in Brazil provide most of the services that are required from banks like payment services, receipts and withdrawals, account applications and credit facilities. A 2013 study revealed the uses of agents as follows:

Payments: 74.4%, Withdrawals: 9.5%, Deposits: 9.1%, Benefit Payments 4.9%, Credit 0.4%, Account opening 0.3%. [Febraban - December 2013] In 2013, via 10,400 agents and 6,100 Banco Postal service points, Banco do Brasil conducted 556mn transaction which amounted to 55% of its total branch transactions. It was also able to reach 2.4mn new account holders of which 1.4mn came via Banco Postal.

The agent banking network allowed Banco do Brasil to expand presence in less time and deploy infrastructure at a lower cost than via traditional models. Because Correos is present in all rural districts, it brings banking to the poorest who are in the most remote part of the country and don't have access to traditional banking services. Banco do Brasil has been able to leverage technology to automate most services resulting in minimal manual work required out of the agent branches.

Similarly, Bradesco operates its agent network via commercial establishments like supermarkets, drugstores, bakeries etc. In 2013, out of 46,851 agent locations it was able to conduct over 43mn transactions every month. Bradesco has also provided exceptional services to its customers in remote locations with 100% being provided with ATM cards, 14.2mn accounts opened via agents and handles over $2.4mn of Social Security benefits monthly.

Brazil is also one of the fastest-growing payments markets in the world, with extensive mobile device penetration and a relatively large unbanked population. With new regulations encouraging more competition in mobile payments and the rollout of successful near-field communication projects in the region, Brazil is keen to use mobile payments to reach the underserved at banking agent locations.

4.2 Postal Banking

Brazil's Correios is regarded as a world leader among postal providers for its innovative use of strategic partnerships with the government and private players. Banco Postal leverages its extensive network of retail outlets in the most remote locations for provision of consumer financial services to the poor and underserved. It operates a network of over 12,000 consumer outlets in more than 5,000 municipalities. It also operates ~4,000 community post offices and another 1,000 franchisee post offices. The post offices provide over 100 products and services like electronic voting, government applications and permits.

In 2002, Correios entered into a 10 year partnership with Bradesco to provide financial services. At that time approximately 45mn adults did not have a bank account and were considered un-bankable. By 2009, over 8.8mn of these people were provided banking services with 1.2mn transactions made daily via the post offices. In this period, over 700,000 loans were also disbursed. Since 2011, after the partnership with Bradesco ended, Correios has tied up with Banco do Brasil and continues to provide banking services to in the remote parts of the country.

4.3 Social Banking

Large public sector banks have played a very important role in financial inclusion. These banks retain very large market share and a wide retail network in many developing countries. Brazilian public sector banks are used to implement policies designed to accelerate financial inclusion like family grants and benefits. The Banco Central Brazil introduced simplified bank accounts requiring less documentation than normal accounts in 1999 to enable banking services to 80% of the population which did not have bank accounts at that time. Caxia Economica Federal opened 8.75mn Caxia Facil accounts by 2010 with an 87% percent market share of these simplified accounts. These accounts are used for direct debit of family grants thereby reducing theft and promoting electronic transactions.

Caxia also extends overdraft privileges to Facil accounts thereby transforming these simple accounts into a payroll credit account as well.

4.4 Crediamigos

The microcredit program run by the Brazilian regional development bank, Banco de Nordeste Brasileiro, Crediamigos accounts for over 80% of micro-enterprise credit in Brazil. Crediamigos was launched in 1998 and has been managed by a partnership between the BNB and Instituto Nordeste Ciadania since 2003. It has been a major agent in implementation of government microcredit policies which allowed it to reach inaccessible and poorest parts of the Brazilian North-East. It operates in 13 of 26 Brazilian states and has presence in 1820 municipalities. It has over 1.7mn borrowers (2013) with over $900mn in assets (2013).

Crediamigos provides different types of credit lines depending on the requirement of the business and also provides access to BNB accounts and insurance products. Crediamigos has pioneered micro-insurance in Brazil providing life insurance since 2010.

Women account for 65% of the clients while 91% clients have low level of education. Most of the clients are poor although not the poorest in the country. In terms of the potential impact of Crediamigo on the clients, there seems to be evidence that supports the idea that borrowers are better-off than comparable samples. [Neri Buchman, 2010]

5. BOLIVIA: Microfinance to Full Service

Bolivia has a variety of financial institutions that cater to the financial needs of the people. There are banks, MFIs, cooperatives, savings and credit mutual. But, Bolivia was the first country and so far the most successful in converting MFIs into full-fledged banks. [Banco Fie, Banco Sol]

5.1 Banco Sol

Banco Soladario started as an NGO (PRODEM) in 1986 with the aim of supporting development of micro-enterprises. PRODEM provided small working capital loans to groups of people dedicated to similar activities who were jointly and severally liable for and guarantors of their obligations. To meet the credit demands of its growing base of customers, in 1992 Banco Sol established itself as a commercial bank dedicated solely to microfinance, with $3m of start-up capital. This made it the first chartered microfinance bank in the world. Today, it offers a full portfolio of non-credit products, Utilities collections, Wire Transfers, Debit Cards, ATMs, housing credits for Bolivian migrants, international wires and warranties.

Banco Sol is designed to lend money to the poor. It lends small amounts of money to self–employed individuals at commercial interest rates and accepts deposits from the same client base. Banco Sol has an excellent repayment record that has a lot to do with careful screening of borrowers, small–group joint liability, quality service, perception of institutional continuity, and the use of the profit criteria for lending. Banco Sol's interest rates are about 20 percent higher than those of the downtown commercial banks. In Bolivia, banks belong to large financial groups and lend only to individuals personally known to the bankers. Banco Sol clients do not have access to these banks. Alternative sources of funds for Banco Sol customers is, the moneylender who charges effective annual interest rates from 88 percent to 3,600 percent. The demand for Banco Sol's services is large. Its products – loans and deposit facilities – and its financial technology are simple. Banco Sol services a particular, large segment of the market in which its technology overcomes many of the problems that apply to small borrowers.

Banco Sol essentially bases its lending methodology on individual credit technology. The average loan is US$ 1,700. Microcredit loans have terms between 1 up to 60 months and 120 for micro housing loans. Loans can be used for working capital, investment purposes on productive assets. Clients are self-employed micro-entrepreneurs that have a minimum of one year of experience in their current occupation

6. European Experience

In Europe, savings banks and cooperative banks started around the mid-18th century. These socially oriented banks were started by religious orders, royal concessions, local administrations or philanthropists. These institutions supported productive activities by farmers, urban laborers and small artisans. These banks gained significant market share by the 19th century and were able to survive the turmoil and regime change of the early 20th century. After World War 2, they became central to the European socialist economies and welfare states. [Mura 1996]

Savings Banks started as local deposit and loan institutions. However, by the late 19th century, independent savings banks had formed associations to provide payment and transaction services through clearing houses and other wholesale banking products. This 2 tiered structure still remains a significant competitive advantage for these banks.

Cooperative Banks are deposit taking and loan making institutions that started with the Schultze-Delitzsch and Raiffeisen movements. These were philanthropic self-help institutions that encouraged workers to join resources and were designed to counter famine, failure in labor markets and problems with public grants.

Credit cooperatives had flourished by the early 20th century only to succumb, in many cases, to nationalism, xenophobia and mobilization for World War I. Moreover, by the 1920s in Italy and 1930s in Germany, Spain and Portugal, fascist and phalange movements centralized cooperative banks and credit unions under single party and central government control. After 1945, cooperative banks regained autonomy and acquired large market shares in many European countries, while remaining less important in market centered economies such as the US and UK. Cooperative banks also have responded unexpectedly well to market oriented reforms since the 1980s. Instead of disappearing, the social mission and identities of cooperative banks helped these institutions to adopt new technologies and ride out crises in the early 21st century.

7. GERMANY: Regional Knowledge and Focus

7.1 Sparkassen

German Savings Banks (Sparkassen) provide the majority of finance to German industry and particularly to the Mittelstand. They provide not just finance, but are obligated by their constitution to support the sustainable development of the total economy within their defined geographic business area. They also have very significant social responsibilities that extend well beyond provision of banking services. These Savings Banks are not state banks but are essentially credit institutions operating under public law. Their responsible public bodies (but not owners) are the local municipalities. Savings Banks are not a consolidated group; each Savings Bank is an independent credit institution and is highly autonomous. They, however, come under an umbrella organization, the DSGV that ensures effective and efficient operation with very low risk.

Savings banks provide the whole spectrum of banking services for private and commercial medium-sized customers. They have about 50 million customers which maintain business activities with savings banks.

7.2 Landesbanken

The Landesbanken are a group of state-owned banks of a type unique to Germany. They are regionally organized and their business is predominantly wholesale banking. They are also the head banking institution of the local and regional bases of Sparkassen.

7.3 Landesbausparkassen

The Landesbausparkassen are subsidiaries of the Sparkassen and its associations and are regionally organized focusing on real estate banking. There are 10 Landesbausparkassen in Germany and their combined balance sheet has total assets of ~EUR 52 billion. Core business of the Landesbausparkassen is the offering of collective real estate saving products (Bausparen) and providing of low-interest residential mortgage loans.

8. UK

8.1 Credit Unions

Credit unions are member-owned financial cooperatives operated for the purpose of promoting thrift, providing credit and other financial services to their members. Credit unions in the UK offer a wide range of services including current accounts, payroll deductions, standing orders and insurance. Credit unions have been regulated by the Prudential Regulation Authority for prudential purposes and the Financial Conduct Authority for conduct purposes since 1 April 2013. Before the Credit Union Act 1979 was passed, there was no special legal structure for credit unions in the UK. Some of the early credit unions chose to register under the Companies Act and some under the Industrial and Provident Societies Act. UK credit unions are covered by the Financial Services Compensation Scheme (FSCS), which protects savings in banks and similar institutions up to £85,000, covering about 98% of people.

8.2 Trustee Savings Banks

Trustee savings banks originated to accept savings deposits from those with moderate means. Their shares were not traded on the stock market but, unlike with mutually held building societies, depositors had no voting rights; nor did they have the power to direct the financial and managerial goals of the organization. Directors were appointed as trustees (hence the name) on a voluntary basis. To create trust among potential depositors, the Savings Bank (England) Act 1817 required funds to be invested in government bonds or deposited at the Bank of England. The Act specified duties of the treasurers, managers and trustees of the savings banks, none of whom was to derive any benefit from their office. There was little competition between the various trustee savings banks. Each individual TSB served a separate geographic area, although other organizations competed with them.

8.3 Mutual Savings Bank

A mutual savings bank is a financial institution chartered by a government, without capital stock, that is owned by its members who subscribe to a common fund. From this fund claims, loans, etc., are paid. Profits after deductions are shared between the members. The institution is intended to provide a safe place for individual members to save and to invest those savings in mortgages, loans, stocks, bonds and other securities and to share in any profits or losses that result. The members own the business. (*Model same as Norway's sparebank*)

9. INDONESIA: Success of Bank Rakyat Indonesia

Indonesia provides one of the major success stories of Rural Banking. Bank of Indonesia continues to update its regulations for new models to succeed in furthering financial inclusion. For example, The Bank of Indonesia required banks to provide a no-frills account from 2010 with limited success; in 2014, regulations were updated, allowing e-money and inter-operability of mobile money account across service providers.

9.1 Bank Rakyat Indonesia: Bank Desa

Bank Rakyat Indonesia is the oldest and largest state−owned commercial bank in Indonesia. It is one of Indonesia's five state−owned banks and lends to small enterprises under the Unit Desa program. The program began in 1984 with the 4,000 sub−branch locations known as the Unit network. Loans are neither targeted nor subsidized and are based upon the appraisal of the enterprise rather than on the value of the collateral.

The Unit Desas (village units) of the Bank Rakyat Indonesia (BRI) were established in the early 1970s to provide credit for agricultural inputs as part of an extension program, BIMAS, encouraging the use of fertilizer−intensive rice cultivation. The country had to increase rice production quickly and authorities thought that the required sudden increase in cash inputs could only be met by providing credit to farmers and that the government was the only possible source of such credit. The BRI Unit Desas were in effect reborn in 1983-1984, when it was clear that BIMAS credit and operating subsidies were going to be stopped. The human infrastructure for a huge financial institution had been developed. The ending of BIMAS could have meant abandoning this banking infrastructure. Instead, the decision was taken to turn the more than 2,000 Unit Desas into full banking units that would be financially viable without further subsidy from government.

In revamping the Unit Desa network, planners decided that savings would be the major source of loanable funds and would carry a positive real interest rate. Interest rates on loans were set at levels high enough to cover all costs, including expected loan losses, and to earn a net profit. The goal was to build a stable and financially viable institution that would earn the trust of the peopleas a place to borrow and to keep savings. The credit operations of the Unit Desas have grown at an impressive rate since 1983. Loan losses are well controlled, and the unit desas are now consistently profitable. The savings response has been even more impressive. The Unit Desas now provide a steady flow of the financial services needed by the people in rural areas.

The Unit Desa system is the single most important nationwide banking network in the country. Operated as an autonomous financial entity within BRI, the Unit Desa system mobilizes resources and provides nonsubsidized loans (Kupedes) to creditworthy small borrowers. Under the Unit Desa program, interest rates on loans are set to cover costs and net a profit. There is a strong emphasis on continuity, prompt approval and the availability of the follow−on loans based on good repayment. Attractive positive real interest rates are paid on deposits and unlimited withdrawals are permitted. Incentives are provided in the form of profit−sharing for employees and interest rebates to customers for prompt repayment. Close supervision and effective loan portfolio management are key to program success.

Bank Rakyat has been able to build a base of over 30 million depositors by tailoring the savings products to the need of the borrower thereby incentivizing them to better utilize their savings accounts.

9.2 Village Credit Agencies – Bandan Kredit Desa

The Badan Kredit Desas (BKD) is a system of village-owned financial institutions mostly in Java providing small loans and savings products. Each BKD unit is owned by an individual village, and operated by three residents of the village. Units generally transact business only one day per week, operating from a public building.

BKDs were established with small capital grants from provincial governments. Their loan capital is derived primarily from this initial grant, retained earnings, and required and voluntary savings. BKD units sometimes also borrow from BRI, other BKD units, local governments, and other parties. In practice however, most BKDs keep large deposits with BRI branches or Unit Desa and have little need of loans.

10. Lessons for India

Increased access to financial services holds promise in reducing poverty and spurring economic development. [Karlan and Murdoch, 2010] But, in practice, commercial banks have had difficulty providing such access profitably. Varied methods have been tried to provide access to the unbanked around the world with mixed success. But, there is reason to be optimistic; many counties have succeeded to varied extent in providing financial access to the poor. Some have innovated in their business model while others have been helped by governments or regulators.

MOBILE: Kenya has shown the path of digital access to financial services to developing countries. This was made possible with the help of CBK which provided help and favorable regulations to make digital access possible. When Sri Lanka adopted mobile money regulations, it allowed banks and non-banks to provide the services, eased KYC norms and generally provided boundaries within which companies were free to experiment with the business model.

The RBI on the other hand a) allowed only banks to operate mobile money services b) restricted types of BCs allowed c) restricted fees and d) restricted the number of banks BCs could work with. The RBI also pushed for a wide variety of services to be provided and more general financial inclusion mandates. In addition to these, there was a lack of coordination with the telecom regulation which resulted in a very slow uptake of mobile money services.

There is reason enough to be positive about the outlook of mobile banking in India with the licensing of new payment banks among which 4 are telecom operators.

DISTANCE: A survey by Brand Fusion in UP found that the average distance of a household from a post office is about 2km. This would suggest that the financial inclusion strategy in India should leverage the postal network by augmenting the services provided at the post office. India Post has a long history of providing savings products in India (NSC) but the number of services was never expanded. In RBI issued a payment bank license to the Department of Posts last year which will allow India Posts to expand its services and provide payment services along with already existing savings products. There is a proposal to launch a Postal Bank in India as well. Leveraging the postal network will lead to a major push for financial inclusion in India as it has the ability to brook the reach and financial education barriers at one go via trained postmasters. India has a very successful example set for it to replicate in Banco Correos of Brazil. If it manages to replicate the success of Banco Correos, it will be a major gain for financial inclusion.

PRODUCT: The major innovation of the Grameen Bank was in collateralizing credit risk and modifying the re-payment schedule. Similarly, the financial needs of the poor in India may not be similar to the rich. This would require out-of-the-box thinking on the part of financial institutions and some leeway from regulators as to what products can be provided. For example, Chit Funds have been operational in India for a very long time, functioning as ROSCAs in many other countries do and are used as a savings/borrowing product by the poor. The institutions would need to be cognizant of the agricultural cycle and the financial flows in the rural areas and be able to customize products for them.

About PIF

Pahle India Foundation (PIF) is a not for profit, financial, economic and political research think tank, dedicated to the task of making India first by putting India first. Over the years, we have learnt that there is no universally accepted development model. Each country has to take into account its people, its resources and its socio economic and cultural legacy for effective policy formulation and implementation. At PIF, we work towards this objective of creating the necessary paradigm shift in development thinking and practices in India to achieve this aspirational goal. PIF currently has an analytically strong team of dedicated researchers who are self motivated. PIF's highly qualified team specialises in analyzing India's political economy and its engagement with the global flows in finance, trade and technology.

Pahle India Foundation
C4/54 First Floor, Safdarjung Development Area,
New Delhi - 110016
(+) 91 11 41551498