MICROFINANCE AND FINANCIAL INCLUSION – CONTEMPORARY CHALLENGES FOR BANKS

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Abstract

Microfinance India is a national platform that strengthens the microfinance sector through high quality research, intellectual debate and knowledge dissemination. Microfinance is a source of financial services for entrepreneurs and small businesses lacking access to ban king and related services. The two main mechanisms for the delivery of financial services to such clients are: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking. In developing economies and particularly in rural areas, many activities that would be classified in the developed world as financial are not monetized: that is, money is not used to carry them out. This is often the case when people need the services money can provide but do not have dispensable funds required for those services, forcing them to revert to other means of acquiring them. Today the MFIs want the government to empower them for mobilising savings. With increasing demand for rural finance, and the inadequacies of formal sources, the MFIs have immense opportunities in the new avatar of micro credit in India. However, in the light of recent experiences, and the need for qualitative growth, we suggest that MFIs should be managed with better scrutiny in terms of finance and technology as well as social responsibility. This is of utmost importance in order to upgrade MFIs from thrift and credit institutions to capacity -building and livelihood-sustaining associations of people. NGOs have played a commendable role in promoting Self Help Groups linking them with banks. Hence, the present study focuses on Microfinance and Financial Inclusion and its Contemporary Challenges for Banks. The study based on Secondary sources of data collection.

***Keywords**: National Platform, Source of Financial Services, Lacking Access to Banking Services, Dispensable Funds and Capacity-Building and Livelihood-Sustaining Associations.*

Introduction

Over the past several decades, the economic and banking sector in the country have taken significant strides to achieve profitability stability and competitiveness to cater to the increasing demand for financial services. It is expected that all sections of the society will benefit from these developments, Financial inclusion is both crucial link and a substantial first step towards achieving Inclusive growth. Financial Inclusion (FI) is enabling access to banking services at an affordable cost to the vast section of disadvantaged and low-income groups. Unrestrained access to public goods and services is the sine qua non of public policy of a nation. As banking services are in the nature of public service, provision of banking and payment services to the entire population without discrimination should be the prime objective of the public policy.

The spread of banking facilities, though impressive, has been uneven in the country, throwing up challenges for achieving financial inclusion. In fact, despite impressive growth of branch network in India, the vast sections of the society remain financially excluded and continue to remain away from the formal system and thereby access to financial services including savings, credit and insurance. The banking industry in India has shown tremendous growth in volume and complexity during the last few decades.

Microfinance and Financial Inclusion

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

Present Scenario

Though there has been widespread prevalence of exclusion, it is, however, important to recognize that in the policy framework for development of the formal financial system in India, the need for financial inclusion and covering more and more of the excluded population by the formal financial system has always been consciously emphasized by the Reserve Bank of India and the Central Government. The Reserve Bank of India in its annual policy Statement of April 2005 recognized the problem of financial exclusion and since then has initiated several policies aimed at promoting financial inclusion.

We have an extensive banking infrastructure comprising 33, 411 rural and semi-urban branches of commercial banks over 14, 501 branches of RRBs, around 12,000 branches of DCCBs and nearly 1,00,000 cooperatives credit societies at the village level. There is at least one retail credit outlet on an average for about 5,000 rural people, which translates into one outlet for every 1,000 households. Further, the extent of credit inclusion is even lower at 14 per cent of per cent of adult population. The financially excluded sections largely comprise 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.

India's banking industry will face two challenges-an economically viable solution for financial inclusion and human resources framework-in the next one decade identified by a survey conducted by Boston consulting Group (BCG) and Indian Banks' Association (IBA). The first pertains to the rising expectations from banks to find an economically viable solution for financial inclusion and the second pertains to human resources. While the first challenge demands unusual innovation and experimentation, the second threatens to cripple the ability of the largest segment of the banking industry from being able to innovate and stay competitive.

Due to the legacy of several decades, public sector banks will witness an unprecedented loss of skills and competencies in the form of retiring senior and middle management executives over the next few years. That coupled with the need for large-scale re-skilling, attracting and retaining fresh talent, controlling growing employee costs and introduction of performance discipline are significant challenges. Boston Consulting Group, Partner and Director, Suarabh Tripathi expressed that banks need to create a business model for financial inclusion from scratch to keep it true to its economic imperative and ring-fence it from the current business. The unique complexities of the public sector make conventional HR solutions ineffective.

In this sense, financial inclusion poses policy challenges on a scale and with an urgency that is unique for developing countries like India. Finding solutions to encourage greater financial inclusion has not typically been a core activity of central banks or other financial regulators. But, the widespread realization that financial inclusion is critical for poverty alleviation, balanced economic growth and economic stability has resulted in growing leadership and ownership of the issue by policymakers. Financial inclusion is important simply because it is a necessary condition for sustaining equitable growth. There are few, if any, instances of an economy transiting from an agrarian system to a post-industrial modern society without broad-based financial inclusion.

As people having comfortable access to financial services, we all know from personal experience that economic opportunity is strongly interwined with financial access. Such access is especially powerful for the poor as it provides them opportunities to build savings make investments and avail credit. Importantly, access to financial services also helps the poor insure themselves against income shocks and equips them to meet emergencies such as illness, death in the family or loss of employment. Needless to add, financial inclusion protects the poor from the clutches of the usurious money lenders. Financial inclusion will make it possible for governments to make payment such as social security transfers, National Rural Employment Guarantee Programme (NREGA) wages into the bank accounts of beneficiaries through the "Electric Benefit Transfer" (EBT) method. This will minimize transaction costs including leakages. In parts of the country where such EBT has already taken off, the results are impressive and the experience of both payers and recipients extremely satisfying.

Connecting People with Banking System

Financial inclusion is not just credit dispensation; it's about connecting the people with the banking system for availing bouquet of financial services including access to payment system. The critical issue, in the first place, is to connect and the SHG ban linkage programme since the 90s ranks, by far, the major programme initiative without parallel in any parts of the world for the financial inclusion. The uniqueness of the SHG Bank Linkage programme lies in the fact that it is not more delivery of financial services but has an inherent gets more sustainability and stability in terms of being inclusive on a long haul. With more than 2.3 million SHGs reaching more than 30 million poor households the first small but significant step has been taken in financial inclusion. The SIDBI engagement with Microfinance institutions has proved to be a significant step forward with MFIs chipping in effective compliment for the banking system as a vehicle for delivery and connectivity.

Technologies Initiatives for Financial Inclusion

Technology holds the key to further the process of financial inclusion, more so in the remote and far flung areas. It enhances access to financial services in a cost effective manner and over time with increasing volume lead to more affordability. The challenge lies in making the technologies friendlier to the illiterate clients from the poor segments of the society, who are normally excluded from the financial system. Some of the initiatives which are currently under way on experimental basis are worth mentioning.

ATMs with operating instructions in vernacular language facilitating the access for the poor people with reading ability. ATMs with voice recognition for the illiterates for transactions relating to savings, credit and payment services. Bio metric enabled ATMs to bring more illiterate poor to the banking fold. Mobile teller/ low cost ATMs in the remote areasand KIOSK banking using the internet facility.

Issues and Challenges

The vast segments of population particularly poor segment of society are out of the formal financial system. The financial inclusion process should take the banking services to the poor rather than poor people coming to the bank for availing the services.

- For sustaining the financial inclusion, the financial literacy becomes a very critical component. There is a need to simultaneously focus on the financial literacy part besides the delivery/access.

- Penetration of insurance services – Insurance services largely remain as the urban phenomena. It should reach out to the rural and remote areas and to the poor segments of the societies. Micro Insurance Services should be given greater importance while extending the financial services.
- From the demand side, the big barriers are the lack of awareness about financial services and products, limited literacy, especially financial literacy of the populace, and social exclusion. Many of the generic financial products are unsuitable for the poor and there is not much of an effort to design products suitable to their needs. The unfriendly and un empathetic attitude of the banks to the customers also plays an important role in undermining the demand for financial services.
- On top of that, exorbitant and oftentimes non-transparent fees, combined with burdensome terms and conditions attached to the financial products, also dampens the demand. From the supply side, the main barrier is the transaction costs that the bankers perceive. Because of current low volumes, banks find that extending financial services is not cost affective.
- Furthermore, lack of communication, lack of infrastructure, language barriers and low literacy levels all raise the cost of providing services and inhibit bankers from taking initiative from the supply side.
- There is a need to closely monitor the progress made by the banks as per their financial inclusion plans.
- It should be seen beyond state benefit transfers. Loans must be extended and savings and borrowings habits need to be inculcated among the poor.
- Social exclusion need to be addressed on urgent basis to make financial inclusion more meaningful and result-oriented.

Conclusion

Banks need to redesign their business strategies to incorporate specific plans to promote financial inclusion of the 'bottom of the pyramid' group, treating it both as a business opportunity as well as corporate social responsibility. They have to make use of available resources including technology. Reaching the unreached is to be done in quickest possible time in a cost-effective manner. Financial inclusion is a win-win opportunity for the poor, for the banks and for the nation. Because of growing incomes, and improving awareness levels, aspirations of the poor are on the rise. We will not be forgiven if we do not rise up to meet these aspirations if only because of poverty of imagination. It is for the banks to convert what they see as a dead-weight obligation into an exciting opportunity and move on aggressively on financial inclusion. It is no longer a social responsibility; it is a business proposition for the banks.