'INCLUSION IS NOT CHARITY'

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MUMBAI

Spreading financial services to unbanked areas should be a viable business for banks and not charity, Reserve Bank of India (RBI) deputy governor K.C. Chakrabarty said at *Mint's* roundtable on *Architecture of Financial Inclusion: The Indian Model* in Mumbai on 31 July.

Chakrabarty said India's regulations are flexible enough to support financial inclusion but this cannot happen without proper use of technology. About half of India's population does not have access to formal banking services.

Two representatives of the microfinance industry insisted that microfinance institutions (MFIs) can play an important role in spreading banking services, provided they are allowed to collect deposits. Chakrabarty said they would need to become banks in that case.

The panellists included Vijay Mahajan, chairman, **Basix Group**; Rajiv Lall, chairman, **IDFC Ltd**; Alok Prasad, CEO, Microfinance Institutions Network (MFIN); Sashi Jagdishan, chief financial officer, **HDFC Bank Ltd**; and Shashwat Sharma, partner, financial services, KPMG. Tamal Bandyopadhyay, deputy managing editor of *Mint*, moderated the discussion. Edited excerpts:

Tamal Bandyopadhyay: Why does half of India's population still not have access to formal banking services?

Vijay Mahajan: Microfinance has played an important role for poor and its weakening has pushed several poor borrowers back to the hands of moneylenders. Today, because of what one state government (Andhra Pradesh) did, millions of people have lost access to financial inclusion. Secondly, 10 million Indians got de-insured between 2011 and 2013. They neither have life insurance nor do they have the minimum cover offered to all microfinance borrowers as a rule.

K.C. Chakrabarty: We will be ignoring what banking system in this country has achieved if you go back to 1960s, so it is not correct to say that banks have miserably failed in spreading banking services. Banks have done a tremendous good work but they have not done many things. Our regulations are flexible to support financial inclusion, especially when it comes to the know-your-customer (KYC) norms for poor. But it cannot happen without proper use of technology. That is certain.

Shashwat Sharma: I do not consider technology alone as the manna from heaven. The business should be viable. Understanding of the customer segment is important. That is the basic of any viable business model. People talk about business correspondent model, but have you thought through that can I use the lending model of a milk federation for giving a loan to a farmer? Technology is important but the linkage to urban, the linkage to SME (small and medium enterprises) segment, the linkage to SSI (small scale industry) segment is very critical.

Sashi Jagdishan: Somewhere around 2009, we realized at HDFC Bank that the poor need to be involved in our scheme of things. That there is a need for the top management to get involved. Somewhere I think we have been fortunate enough to give something back to society. We have a very specific simple plan and have a product range catering to individuals.

We need a brick and mortar branch with three-four people and a small 500-1,000 sq ft office that will probably meet the requirements. Once we have this kind of infrastructure, what we need to do is to take the products and sell but one more thing we need —that is passion. If we do not have that, it will never be a success.

Alok Prasad: The issue in my mind is that, is there architecture for financial inclusion or is it just a mishmash? Even today, we are only experimenting... we are not addressing the heart of the matter.

Rajeev Lall: We have to find different models to spread financial services and that is why financial inclusion is important. No rocket science is needed to provide financial inclusion to the base of the pyramid. Not one model will be enough; we will have to encourage several models.

There is greater flexibility in terms of the RBI regulatory environment, which has become much more supportive. There is no new fundamental technology that we require but the penetration of that technology is needed. There is a new opportunity now to have a new banking plan. The full dynamics of rural India has changed. It has become much more of a real opportunity than it was before.

Bandyopadhyay: But is financial inclusion as business viable, especially for microlenders as they are not allowed to access public funds?

Mahajan: We are being treated as pariahs. There is no significant country in the world where microfinance institutions are not allowed to take deposits. There must be something that we know which the rest of the world seems does not know.

Only four of the local area banks formed in 1997 have survived. I run a local area bank in the three poorest districts of Andhra Pradesh. It has a quarter of a million customers with a ₹200 crore balance sheet. Average deposit balance in the 10th year per customer is ₹2,100. That is financial inclusion and it is done in a viable manner and has been profitable since birth.

If India's policy makers actually care about financial inclusion, they would look at this model.

Today, we should have had 500 local area banks. In the US, there are 9,000 community banks. Let's try to look around the world and emulate them in their models. If you want to learn lessons, we should say that we have tried many things but we fall short on many things. The banking system of India is the banking system of south Mumbai.

Chakrabarty: I need to clarify on certain things. We have 2,000 urban cooperative banks and 400 district central cooperative banks. What have they delivered? Microfinance institutions have miserably failed. Money business is not an easy business. We cannot do any service to the poor unless we have a business model and that has to be supported by the technology. Unless you realize that, this will never happen. Globally, one of the reasons of the crisis is shadow banks.

MFIs are shadow banks and they have no future. If you do not see the writing on the wall, I cannot help you. When you say that you should be allowed to take the deposits and lend, you must become a bank and regulated like a bank.

I agree that we require many large banks and different types of banks. RBI is working towards that.

MFIs have done a commendable job. That is because there are no banks. MFIs have a role to play in the next 10 years to bring unbanked people into formal banking fold.

Jagdishan: There is huge market opportunity. About 70% Indians are in the rural areas and even if you take 50% of that, they are being under served. There is enough opportunity for the existing banks, if you do business without losing your credit standards. There is definitely opportunity and we will work on this as our key strategy. Financial inclusion is a subset of our rural strategy. We believe if we can uplift 1.7 million households in a short span from 2010, by giving them sustainable livelihood, we can do more in this space. But you have to be patient and you can see margins in five-six years. It takes time to build the business and make profit but there is no problem in quality of assets. People don't default because of peer pressure.

Prasad: What we need is different class of institutions, which are structured and organized. The regulator has to look at the whole story and see what is right. Look at the world and see what works and what does not work, apply all that. Why can't we just sit back and see what has gone wrong? Ultimately, it's about everyone working together and see what is good for the country. We have failed there. What is important is recognizing that failure and working towards making it successful.

Sharma: Any financial inclusion business model which looks at linkages between various segments in the banking industry will be very critical for its long-term viability. I would say the operating model has to be more focused on the particular segment that it serves and have a better understanding of the segment.

Bandyopahdyay: We always talk about financial inclusion in India's hinterland but what about financial inclusion in urban India?

Lall: For lack of inclusion in urban India, I don't think the regulator should be blamed. It's really a mindset issue. There is nothing that prevents banks from reaching out to the urban poor. Let me give you an example in impact investing. If you are trying to create a financial services company that operates in low-cost housing, there may be a management view that why should it go to low-cost housing while there is enough to do in middle-class housing. Like that, the reason why banks are focusing on the corporate segment is that there is a lot of opportunity still there. Until you exhaust it, you will not move to the next layer.

Sharma: For most of the banks, based on their current operating model, operating efficiencies and cost structure may not be suitable for all segments of clients. It will be very difficult to manage different sets of clients such as corporate clients, high net worth individuals and slum dwellers, using the same formats. Based on the customer segment the bank is approaching, the banks will have to use the appropriate operating model, mindset and risk assessment. Financial inclusion also requires financial literacy.

Bandyopadhyay: What should be the driving factors for financial inclusion?

Chakrabarty: You cannot make any service or product universal if you have no technology. If you say poverty has to be removed overnight, it is not going to happen. If it could not happen, it could not happen because of technology. Still we are experimenting with the delivery model, we have to innovate, we have to take it forward.

Prasad: What we need is multiple institutions, and more players that are much better connected to that end of the market. I think there is no escaping the fact that the existing mix in large banks is not that; they are something else. Therefore, we just need to be looking at what are the possible institutions. Whether you promote the MFIs upwards to becoming small banks, (that) could be one approach. Other models could be, give them more regulations, give them more space to operate, and allow them to do a few more things as allowed globally. We need more players in the financial sector and small players may become more specialized, and we need to do that in the market.

Jagdishan: You need reach, execution, passion and you need much more engagement. I just realized the amount of time invested by our field officers in these groups and the intensity of the exercise is much more than what bank advisers do for high-profile businesses. Probably that is the key to success.

Lall: There has to be a balance. Any business model that allows low-cost delivery of services, highly talented people and a model that does not force systemic risk is the ideal business model. More important than an ideal model, through regulations for start-ups and new beginnings, we are at an inflection point. Whether a set of new banks comes up or not, we are at an inflection point where we are going to redefine financial inclusion in the next decade.

Mahajan: Banks have a special status in society. If that status is important to them, they must also have an obligation to society and that obligation is a universal services obligation. We use that phrase in telecom, see the telecom industry. In the case of a bank, its south Mumbai branch does not serve the drivers and maids but this does not happen in the telecom sector. The tele-density of lower income groups is comparable with the tele-density of the high-income people. There are industries right here in this time and space which believe in penetrating but unfortunately banks do not

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Our regulations are flexible to support financial inclusion

K.C. Chakrabarty
Deputy governor, Reserve Bank of India

There is enough opportunity, if you do business without losing your credit standards

SASHI JAGDISHAN
Chief financial officer, HDFC Bank Ltd

Because of what one state govt did, millions have lost access to financial inclusion

VIJAY MAHAJAN
Chairman, Basix Group

Look at the world and see what works and what does not work, apply all that

ALOK PRASAD
CEO, Microfinance Institutions Network

No rocket science is needed to provide financial inclusion to the base of the pyramid

RAJIV LALL
Chairman, IDFC Ltd

The operating model has to be more focused on the particular segment that it serves

SHASHWAT SHARMA
Partner, financial services, KPMG