Is Financial Inclusion Imminent in India?

Bhagwan Chowdhry

Professor of Finance and Faculty Director, MFE at UCLA Anderson School

Is Financial Inclusion Imminent in India?
Nearly half the world has no access to even simple financial services such as savings. In India, nearly 70% of the people are estimated to be excluded from formal financial services that most people like you and I who are reading this blog take for granted. There are a number of efforts in India to bring financial access to the poor. I spent a month in India talking to social entrepreneurs and senior government officials learning about these efforts and discussing with them, with Vijay Mahajan, social entrepreneur and founder of Basix India, and co-founder of Financial Access at Birth (FAB) campaign, ways to make financial access a reality for everyone.

It is clear that the traditional model of delivery of banking services, in a bank branch, is not appropriate for the poor for two important reasons. First, Because the size of the transaction services needed by the poor are small, the transactions costs as a proportion of the amount transacted are way too high in the traditional branch banking model. Second, the poor are uncomfortable transacting in a bank branch because it is inconvenient, takes a long time and the procedures are too long and confusing for them. So if financial services are to become a reality, they will have to be delivered in non-traditional places and the costs of transactions will have to be brought nearly close to zero.

In Hyderabad, I was invited by Shiva Kumar, the chief general manager of State Bank of India (SBI) -- the largest public sector bank in India -- to visit and see the operation of an SBI kiosk, called Customer Service Point (CSP), a mini savings bank account that can be opened with an initial deposit of just one rupee (approximately two U.S. cents). The no-frills kiosk is located in a busy, relatively poor urban setting in Hyderabad and is managed by a start-up called Geosansar.

There was a young man working at the kiosk with a netbook that was connected to the internet using a USB wireless data card. He demonstrated a live opening of a new one rupee account. A biometric fingerprint capture device, made in Taiwan that costs about U.S. $50, was connected to the USB port of the netbook. He swiped three fingers from each hand, one finger at a time (three times for a consistent reading), for a new customer.

He then took the customer's picture using the webcam of his netbook, entered in the customer's name, address etc. (all this information is transmitted to the SBI sever, nothing is stored on his laptop ) and voila! -- was the account created? No, not so fast, I was told. He then took out a paper application form in which he filled the same information, printed and pasted customer's picture on the form, made him sign the form (if the customer cannot sign, they take the customer's thumb print) and he would mail the form to SBI's main branch. After the main SBI branch receives the application, someone there verifies the information and then SBI mails to the customer his bank account information and an ID card that has his picture on it in seven to 10 days.

The last part of the procedure, filling out the paper application, mailing it in and waiting for the ID and account information -- seemed superfluous and unnecessary to me. After all, hadn't he just entered all this information and uploaded it on the SBI server? I was first told that the paper application was necessary because an SBI officer needed to "verify" the information. How? The same information appears on both the online and the paper application. If all that was being checked was if the young man at the kiosk had made typos in entering the information, one could ask him to type in that information twice! I was then told that creating a paper application was a regulatory requirement -- a requirement that seemed meaningless, costly and one which would make the opening of the account less attractive.

The cost of maintaining a kiosk is Rs 20,000 (about U.S.$400) a month, besides an initial one-time cost of Rs 70,000 (about U.S.$1,400). SBI has outsourced this operation to a company called Geosansar who gets a fee of 0.5 per cent for each transaction.
In New Delhi, Vijay Mahajan and I met Abhishek Sinha, the founder of EKO, who has pioneered an innovative approach to bringing instant financial inclusion using only a mobile phone and delivery of financial services such as cash deposits and withdrawals, both for SBI and for ICICI Bank -- a private sector bank in India -- in retail stores, here again called, Customer Service Points (CSP).

To open an account, the customer needs to bring one photograph and a proof of address to the retail store, which then fills out a paper application form which is sent to the bank. The retail store owner who acts as a bank correspondent also has an account with the bank. There is a one time fee of Rs 100 (about U.S. $2) to open an account. After opening the account, there are two plans offered. In the Premium Transaction Plan, for an yearly maintenance fee of Rs 100, all transactions, deposits, withdrawals and transfers, are free. In the Basic Transaction Plan, there is no maintenance fee but each transaction, deposit, withdrawal or transfer, costs Rs 2 (about U.S. $0.04) regardless of the amount involved.

The customer receives a booklet containing a series of numbers, which together with a four digit pin that the customer chooses, form the basis of all transactions. Each type of transaction involves punching in numbers on a mobile phone and are sent as a text message to the bank. The confirmation of each transaction is immediately confirmed in the form of a return text message by the bank. No other device or technology is used in the entire procedure.
When the customer makes a cash deposit at the retail store, his or her account is credited and simultaneously the account of the retail store owner is debited by the same amount. The opposite is true of a cash withdrawal. A transfer involves no cash transaction and thus two accounts involved in the transfer are automatically credited and debited. The retail store owner, if he nets collecting cash at the end of the day, deposits this cash with EKO's agents known as "Feet on Street" who visit the store once a day to collect this cash which is then taken to another intermediary known as the super CSP who would eventually deposit its net cash position at a bank branch or an ATM.

Vijay Mahajan and I felt that the transaction fee model could be tweaked a little. For instance, to encourage the poor to save frequently, the transaction fee for depositing a small amount could be made zero for an amount less than Rs 100, and 1% for an amount greater than Rs 100 with a cap of Rs 2 for each transaction. To discourage frequent and small withdrawals, a minimum fee could be charged. Since transfers and remittances involve no cash handling at the retail stores, these could be charged a fee that is a percentage of the amount transacted.

But more importantly, for a model like this to work and eventually lead to use of electronic cash rather than physical cash which is largely responsible for increasing the costs (see this paper by Ignacio Mas of Bill and Melinda Gates Foundation), the availability of financial delivery services at retail stores will have to become ubiquitous. Currently, only a few thousand EKO outlets near Delhi and a corresponding number in Bihar (who are largely recipients of remittances by migrant workers in Delhi area) have these services available. In fact, we had to drive over an hour to find a couple of outlets in an area known as Guragaon!

This is where the role of the government comes in. If there were a push by the Indian government to integrate financial inclusion with a comprehensive scheme such as the Unique ID, headed by co-founder of Infosys and business tycoon Nandan Nilekani, or with Financial Access at Birth (FAB) initiative that we have launched, or with a combination of the two, financial inclusion may indeed become a reality for millions of India's poor in the coming years. The interest on a $100 deposit that we suggest in FAB initiative would be enough to cover the transaction costs of $2 per year that seem to make EKO type accounts feasible (a CGAP study documents EKO to be one of the most transaction cost efficient operations in the world even with the estimates reported in the study which seem high to me). Our discussions with senior government officials suggested a great deal of optimism and possibilities. So, even though the SBI and EKO models currently seem clunky and not easy as using cash or credit and debit cards, the creativity of entrepreneurs leaves us hopeful and excited.
AOL Travel News: Robert Vietze, JetBlue Passenger, Pees On 11-Year-Old Girl On Flight (UPDATE)
Like
635

Noisecreep: Former Warrant Vocalist Jani Lane Dead at 47
Like
8K

The Top 3 WORST WAYS To Save A Marriage
Like
645

Janet Turley Sweet Cherry Pie
Like
389

Autoblog: Is this the most sexist ad of all time?
Like
995

Daily Finance: America's Best Places to Live
Like
96

Don't Miss HuffPost Bloggers
1 of 5

Marlo Thomas
Gloria Steinem...the Icon, the Girlfriend
Shepard Fairey
Shepard Fairey On Street Art And Politics In Copenhagen

• FRONT PAGE