MicroSave Briefing Note 46

Who Says You Can't Do MicroSavings in India? Part 2: "Conventional Finance"

Chris Linder with contributions from Denny George

July 2010

The first note in this series provided a brief profile of the community-based methods of providing savings to the underserved in India. In this second note, the focus now turns to the more conventional and regulated sector of the Indian financial market, which has its own set of opportunities and challenges.

Banks[1]

Public and private sector banks represent the largest base of savings providers in India. The 165 banks in India had over 82,000 branches, 38.9% of which were rural (versus 42% in 2008), with 412 million accounts and Rs. 8 trillion ($178 billion) as of March 2009. The average branch had 5,200 accounts and Rs. 97.6 million ($2.2 million) in deposits.[2, 3] In terms of serving the poor, the RBI requires that all Public Sector Banks (or PSUs), representing the majority of banking activity in India, create a financial inclusion plan with targets for opening of special savings accounts geared to the underserved and for meeting priority sector lending targets, which usually involves on-lending to MFIs.

Yet despite the size of the banking sector in India and the mandate to focus on financial inclusion, it is estimated that 70% of all rural individuals still do not have a bank account and that only 5.2% villages have a bank branch.[4] Banks are a classic example in which the theory of "economies of scale" truly matters, e.g. it costs about the same to process a deposit of Rs.100 as it does for a deposit of Rs. 100,000. So banks inherently do not want to meet the typically smaller needs of the rural underserved.

Banks also see the underserved and poor as highly risky, as their incomes are small and unpredictable. This is no different in India or the US and is a constant struggle to convince banks otherwise. Finally, the RBI's own protectiveness of the poor and underserved limits the banks' ability to recover their costs and earn profits by restricting such areas as the ability to charge fees for services rendered.

There are a few enlightened banks, such as SBI, the largest bank in India, that truly want to focus on the underserved segment but still must be convinced that of a viable business model in addition to social benefits. The business correspondent/agent model, mentioned in the fourth note of this series, combined with the appropriate use of technology to drive down cost, is the most likely solution to encourage banks to focus on the poor and underserved in a significant way in the current Indian regulatory environment. Ideally, banks with an inherent mission of serving the underserved, rather than doing so through regulatory prodding, would be allowed and encouraged. This may be a long way off, but amidst the IPO headlines recently, SKS, India's largest MFI, announced it would seek a full banking license from the RBI.[5]

Rural Regional Banks (RRBs)

As of December 2009, there were over 80 RRBs, with over 15,000 branches (only about 18% of what banks represent).[6] The 60.9 million bank accounts held by RRBs at the end of March 2008 was an even smaller proportion of the total held by banks (14.1%).[7] On a comparative basis, the average RRB branch had 4,000 accounts and Rs.34.8 million ($773,000) in deposits. Though outreach is not significant, RRBs do seem to be serving a poorer client with an average account balance of Rs.8,700 ($193) per account versus Rs.18,769 ($423) for banks.

[1] Local Area Banks (LABs) will not be addressed here, even though BASIX, a large MFI, has set-up one to provide banking services to the poor. The reason being is that all four (4) LABs in India face the issue of not being able to scale-up. LABs can only operate in a few districts at a time and must seek a new (and arduous to attain) license for expansion beyond the original scope. The RBI has even gone further to say it will likely not allow any additional LAB licenses: "RBI not to issue fresh local area bank licenses: Finmin," The Economic Times, 16/3/10.

[2] *Quarterly Statistics on Deposits and Credit of Scheduled Commercial banks.*

[3] "Banks need to rethink their branch business model", Business World, February, 2009.

[4] Kochar, Sameer, *Speeding Financial Inclusion*, Skoch Development Foundation, 2009.

[5] "SKS Microfinance Eyes Banking Foray", 18/410.

[6] Quarterly Statistics on Deposits and Credit of Scheduled Commercial banks

[7] Basic Statistical Returns of Scheduled Commercial Banks in India Volume-37 March 2008

Through field research with clients, *MicroSave* has often found that institutions such as RRBs are seen to have a strong reputation/level of trust. These institutions also have a mandate to improve financial access, including savings, into underserved areas, primarily rural, and in particular are heavily involved in credit-linked programmes to SHGs (25% of the total amount in 2009).[8]

However, the incentives to offer savings to the poor and the capacity of frontline staff to communicate and offer these services adequately are often not in place. Additionally, RRBs are often used as training grounds for future leadership positions in their PSU parents, rotating the directors in and out every few years. This revolving door discourages continuity and provides an inherent disincentive to take on new initiatives like growth or new products. There are a few well-run RRBs with a true focus of growing and improving access to financial services, but the challenges for this sub-sector to expand significantly and encourage financial inclusion will remain until structural changes are made and strong direction from the PSU parents is given.

The Postal Service

Of the 155,000 Post Office branches reported in March 2008, over 98% offer some type of savings services. The Post Office controlled 174.7 million savings accounts (or 40.7% of what banks held), accounting for Rs.3.4 trillion in deposits (over $75.6 billion, 42.9% of what banks held).[9] Even more encouraging for financial inclusion is that, quite opposite of the banks, 89.8% of all Post Office locations are in rural areas.

According to its own website, the Post Office offers eight (8) different kinds savings accounts, a life insurance product, and sells money market mutual funds and bonds through a special window.[10] A few Post Office branches have in fact opened as business correspondent operations, and several hundred thousand agents also provide doorstep services. Furthermore, the Post Office has consistently come out on top when it comes to trustworthiness and security of funds when *MicroSave* conducts field research with clients.

Post Office branches on average have only 1,100 savings accounts and Rs23.3 million ($518,000) in deposits each (just over 20% of the typical bank branch).[11] This would imply an average account balance of Rs.21,182 ($471) versus Rs.18769 ($423) for banks and Rs.8700 ($193) per account, meaning that the postal branches are likely serving a much better off end client than even the banks. So, everyone, especially the poor, is not exactly flocking to the Post Office to open a savings account despite the myriad of product choices.[12] What *MicroSave* has found is that the customer service is often poor at many branches, in which clients must often wait long periods of time and almost plead with staff to allow access to their funds.

Anecdotally, *MicroSave* has also heard that many post office branches do not have the right levels of liquidity to handle withdrawals when needed, sometimes requiring waits of 1-3 days. It appears that the incentives and performance requirements have also not been aligned to serving clients, and are also conflicting with staff's other duties, i.e. actual postal services. While it may be very difficult to try to change an entire system of 155,000 branches, one could start with an enlightened branch of the postal service, perhaps one state at a time, and try to improve the level of service there.

MicroSave has had success, though difficult, with Postal Banks in East Africa in terms of improving customer service and offerings. Coupled with the initiative of upgrading the look and feel of branches and linking all branches into a core banking system and the exploration of seeking a true banking licence, the postal system could have tremendous impact on savings for the poor in rural areas.[13] Imagine one organisation that could have the same number of accounts as banks, 5,200 per branch, offered to the poor and underserved, but not across 85,000 branches, across 150,000 branches, or 25% of India's villages!

Conclusion

While one of the primary challenges in the informal, community-based sector lies with a lack of scalability (or the potential for scale), this is generally not a problem for conventional financial institutions. The real challenge lies with the conventional financial institutions not seeing the right incentives, "the carrot," to truly serve the poor. In fact, most of the effort in convincing conventional financial institutions to focus on financial inclusion is through a "stick" approach of threatened punishment by regulatory bodies. The next note will provide ideas that pro-financial inclusion organisations can undertake to help rebalance the Indian microcredit market to becoming a true microfinance market.

[8] NABARD, *Ibid*.
[9] *Book of Information 07-08*, India Post.
[10] www.indiapost.gov.in
[11] India Post, Ibid.
[12] Granted most banks are in dense urban centers, so the potential for more accounts per branch is higher.
[13] "See you at the Post Office", 12/5/ 2010, Rediff Business.