Role of Payment Banks and Small Banks in Achieving Financial Inclusion

Gaurav Taneja  
Narinder Kumar Bhasin  
Gaurav.taneja@axisbank.com  
nkbhasin@amity.edu  
Amity University

Financial Inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of lower income segments of society in comparison to financial exclusion where those services are not affordable or available. Around 2 billion of world’s population have no access to various types of financial services which are provided by different financial institutions like Banks, Mutual Funds, Life Insurance companies, General Insurance Companies, NBFCs (Non-Banking Financial Services), Micro-Finance Institutions etc. It is being generally discussed that as Banking services are good for common Man, the availability of Banking and payment services to the entire population without any discrimination is one of the important objective of Financial Inclusion.

1. Introduction

Financial Inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of lower income segments of society in comparison to financial exclusion where those services are not affordable or available. Around 2 billion of world’s population have no access to various types of financial services which are provided by different financial institutions like Banks, Mutual Funds, Life Insurance companies, General Insurance Companies, NBFCs (Non-Banking Financial Services), Micro-Finance Institutions etc. It is being generally discussed that as Banking services are good for common Man, the availability of Banking and payment services to the entire population without any discrimination is one of the important objective of Financial Inclusion.

In India, this term ‘Financial Inclusion’ was first mentioned in the Annual Policy of the Reserve Bank Of India (Regulator for Banks in India) in April 2005, which was presented by Y Venugopal Reddy, the then Governor of RBI. After this, this term was consistently being talked about by Government of India and RBI and is being used in India. In Annual Policy, it was mentioned that Banks should review their existing policies and practices to align them with the objective of Financial Inclusion. This was the major concern of Reserve bank of India that a vast majority of Population in India, at that time, was not covered in formal Banking Umbrella. After this, RBI implemented the recommendations of Khan Committee Report, by giving directions to Banks to provide “No Frills Bank Accounts”. Further relaxation was given to common public who intends to open accounts with annual deposits of less than Rs 50000/-. The Mainstream Financial Institutions like Banks have an important role to play in this effort not as a social obligation but as a pure business proposition. The push for Financial Inclusion has come from the Government or Regulator at the level of Macro Policy. The Banks have to translate this to concrete outcomes at Ground Level to increase Financial Deepening. Government of India (GOI) and Reserve Bank of India have been actively trying to include people in the Financial System since 1975. Government of India have tried to achieve Financial Inclusion through various schemes like Kisan Credit Card (KCCs), Bhoomiheen Credit Card (Bank of India and Dena Bank), Banking Correspondent-Banking Facilitator Model, Ultra Small Branches, SHG-Bank Linkage Program, Direct Benefits Transfer, USSD Mobile Banking and Swabhimaan Campaign, Regional Rural Banks, Rashtriya Mahila Kosh, Rashtriya Swasthya Bima Yojana. All these schemes were brilliant in Principle. Situation has also been improved in some regions. Banks have expanded their network and their customer base. But in general, the schemes could not deliver the expected results as it was envisaged by Government of India and regulator. Bank Accounts were opened but it did not prevent people from going to Money Lenders as 43% Rural Households still borrow from Informal sources. These schemes had not promoted the habit of saving at a Bank as only 11% of Total Account Holders have saved any money in these accounts in 2011-12. Most of accounts are dormant since they were opened. No transactions had been done, so this cannot be treated as Financial Inclusion. The amount of credit which is disbursed does not seem like bigger achievement as villagers have to grease the palms of middleman/mediators to get the Loan sanctioned. Insurance is difficult task to be penetrated deep as poor people in villages could not afford paying regular premiums.

In achieving 100% financial inclusion, Reserve Bank of India has taken another innovative step by giving In-Principle Approval to corporate entities to set-up Payment Banks as well as in-principle approval has been given to Micro-Finance Institutions for setting up of Small Banks in India. Payment Banks alongwith Small Banks may change the shape of the Banking Sector in India in emerging future. A Total of 11 entities have got In-Principle Approval to set-up Payment Banks, out of which 3 entities have withdrawn their Nomination to
become Payment Bank, so at present 8 new payment banks will be coming in India and 10 MFIs (Micro-Finance Institutions) have got In-Principle approval from RBI to set up Small Banks. Both these measures are really path breaking and can prove to be major success in achievement of Financial Inclusion. Further, in the Union Budget 2014-15 which was presented on July 10, 2014, the Honorable Finance Minister Sh. Arun Jaitley announced that “After making suitable changes to current framework, a structure will be put in place for continuous authorization of Universal Banks in the Private Sector in current Financial Year. RBI will create a framework for licensing Payment Banks, Small Banks and other differentiated Banks. Differentiated Banks will serve niche interests, Local Area Banks, Payment Banks etc are contemplated to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant workforce.

This Research paper attempts to point out the positive impact of Payment and Small Banks for achieving Financial Inclusion. Payment and Small Banks will help in financial inclusion by providing (i) Small Savings Accounts and (ii) Remittance services/Payment Services for Lower income people, small businesses, migrant labour workforce, low income households, unorganized sector firms and other users.

2. Payment Banks & Small Banks – Highlights and Features

Back Ground: Prepaid Instrument Providers (PPI) are mobile operators which issues Wallet and this wallet is connected with customer’s Mobile on the receipt of request by debiting his regular bank Account and through this customer can pay Bills, can do Shopping, purchase movie tickets etc.

Features & Characteristics of Prepaid Instrument Providers
1. KYC Norms will apply as per PMLA Act 2002
3. Max Deposit Limit is Rs 50000/- only.
4. No interest will paid to customers on deposit amount in wallets
5. Cash cannot be withdrawn from wallet except in few circumstances.
6. Money will be utilized or debited for any expenses incurred.
7. Transaction fees will be applicable for each & every transaction. e.g Airtel Money charges 0.5% as commission.

Examples of PPI
1. Airtel Money
2. Prepaid Gift cards issued by banks through online mode.
3. Oxigen Prepaid cards
4. Paypoint
5. Zipcash
6. Flipkart Wallet
7. Freecharge
8. Mobikwik
9. M-Pesa from Vodafone
10. Paytm

Reserve Bank of India appointed a committee under Nachiket Mor, committee observed that
1. No interest rate offered by PPIs. So, this is disadvantage for poor people as they cannot save money.
2. Money which is shown in wallet is deposited in escrow account in some Bank. Every time customer do something using digital wallet, PPI takes out money from that escrow account and pay on behalf of customer. “Contagion Risk” can be increased with nested models. Contagion Risk = Bad thing happens at one place and then it leads to more negative outcomes at other places in the market.

Dr. Nachiket Mor’s thought process was like that
1. Reserve Bank of India should not give licenses to open more Prepaid Instrument Providers.
2. If any Firm or Company is interested, RBI should insist for BCs (Banking Correspondents) or they can apply for Payment Bank Licenses.

Dr. Nachiket recommends RBI to give licenses to new type of banks called Payment Banks (under Banking Regulation Act) to provide payment services, sales of third party investment products, Insurance and Risk Management. Dr. Nachiket Mor, who was Central Board Member, Reserve Bank of India was appointed as Chairman for committee on comprehensive financial services for low income households and small businesses.

Terms of reference
1. To frame a clear and detailed vision for financial deepening and financial inclusion in India.
2. To review existing strategies and develop new ones that address specific barriers to progress and that encourage participants to work swiftly towards achieving full inclusion and financial deepening, consistent with the design principles.
3. To lay down a set of design principles that will guide the development of institutional framework and regulation for achieving financial inclusion.
4. To develop a comprehensive monitoring framework to track the progress of the financial inclusion and deepening efforts on a nationwide basis.

The four Design principles that would inform Financial Inclusion and deepening strategies which were discussed in the report are: Systemic stability, Balance-Sheet Transparency, Institutional Neutrality and responsibility towards the customer.

The framework to understand various types of banking System designs uses the functional building blocks of payments, deposits and credit and constructs two broad designs. These are Horizontally Differentiated Banking System (HDBS) and the Vertically Differentiated Banking System (VDBS). Across these, ten existing and potential Banking Designs were identified. These are: National Bank with Branches, National Bank with Agents, Regional Bank, National Consumer Bank, National Wholesale Bank, National Infrastructure Bank, Payments Network Operator, Payment Banks, Wholesale Consumer Bank and Wholesale Investment Bank.

Initiatives taken by Indian Banking Regulator – Reserve Bank of India.

3. Brief History for Payment Banks and Small Banks

On 17th July 2014, Reserve Bank of India released Draft guidelines for licensing of Payment Banks & Small Banks and sought feedback, comments & suggestions from all interested parties and General Public. The Reserve Bank of India last came out with set of guidelines for giving licenses to new banks in the private sector in Feb 2013. Reserve Bank of India issued important guidelines on its website on Small & Payment Banks on 27th Nov 2014 and clarifications on queries raised on 01st Jan 2015. The last date for submission of applications for Payment and Small Banks was extended till 02nd Feb 2015. RBI had declared that names of all applications would be displayed on RBI’s Website to ensure transparency.

Payment Banks are permitted to take Deposits upto Rs One Lakh per account but are prevented from granting any type of Loans and issuance of Credit Cards. They can sell third party products like Life Insurance Policies, Mutual Funds, Online Demat Trading Accounts etc. Payment Banks are not intermediaries of Credit but are unique in banking industry. They will act as a one stop shop for making all types of payments like payment of utility Bills, Grocery Bills, School Fees, College Fees, Domestic Remittances etc.

This will help common man to undertake his day to day transactions through Payment Banks or can route Transactions through Payment Banks using Mobile Applications. Semi-literate population in the country can be hugely benefitted by these payment Banks as users of Smart Mobile Phones are increasing day by day in India and to carry out Banking transactions, they will use Mobile Applications of payment banks without maintaining huge balances in the account. Compulsion of maintaining huge balances in the account can be done away with advent of payment Banks and moreover ease of carrying out transactions. A lot of unskilled and semi-skilled workers who have been migrated abroad or regions domestically, within India, will find it easier to transfer remittances to abroad or remote locations within India.

The whole process will be very fast and transactions can be expedited in overall financial sector within the country. Payment banks can be new avatar or we can call them as Money Transfer Agency, where one stop Billing to payments is really unique. The New generation or Gen X, may be attracted by the fact that they can do all the banking through their Mobile sitting in the comfort of their homes. Growth of Payment Banks will lead to reduction of currency-Deposit Ratio, which is one of the major components of Money Multiplier. Another
advantage of payment Banks will be that they would not deal with the problem of NPAs (Non-Performing Assets) in their Balance Sheets.

List of Entities who have been granted In-Principle Approval by RBI to open Payment Banks
1. Aditya Birla Nuvo
2. Airtel M Commerce Services
3. Cholamandalam Distribution Services
4. Department of Posts
5. FINO Pay Tech
6. National Securities Depository
7. Reliance Industries
8. Dilip Sanghvi, Sun Pharmaceuticals
9. Vijay Shekhar Sharma, Paytm
10. Tech Mahindra
11. Vodafone M-Pesa

Cholamandalam Distribution Services, Dilip Sanghvi-Sun Pharmaceuticals and Tech Mahindra have withdrawn their application to set up Payment Banks.

Characteristics & Features of Small Banks
Another set of Banks which are going to come in our Banking Sector in India is Small Banks. Small Banks can take Deposits and can also lend money, just like a scheduled commercial Bank in India. As per guidelines laid down by Reserve Bank of India for Small banks, half the Loans which will be given by Small banks should be less than 25 Lakhs. Also, they will not be able to lend more than 10% to a single Borrower and 15% to Group of Borrowers. Small Banks may provide stiff competition to Big Banks in India. Many of the Mid-sized Banks which are not fully equipped in terms of technology and poor quality of Human Resource practices alongwith staff may face a stiff competition and may become nightmare for these Banks.

Other Conditions & Clarifications
1. The operations of the Bank should be fully networked Nad technology driven from the beginning, conforming to generally accepted standards and norms.
2. The Business Plan should be viable and it has to be realistic and viable. Entity has to provide Business plan covering next five years. It should address how the Bank proposes to achieve Financial Inclusion.
3. Bank should keep in place provision for high powered customer Grievance cell to handle customer complaints.
4. The Legal provisions of SARFAESI Act & DRT mechanism will be available to Small Banks also.
5. The requirement of ownership and control by Residents applies to all entities promoting or converting into a Small Bank which also includes NBFCs and MFIs.

List of Entities who have been granted In-Principle Approval by RBI to open Small Banks
1. Au Financiers (India) Ltd., Jaipur
2. Capital Local Area Bank Ltd., Jalandhar
3. Disha Microfin Private Ltd., Ahmedabad
4. Equitas Holdings P Limited, Chennai
5. ESAF Microfinance and Investments Private Ltd., Chennai
6. Janalakshmi Financial Services Private Limited, Bengaluru
7. RGVN (North East) Microfinance Limited, Guwahati
8. Suryoday Micro Finance Private Ltd., Navi Mumbai
9. Ujjivan Financial Services Private Ltd., Bengaluru
10. Utkarsh Micro Finance Private Ltd., Varanasi

4. Concerns & Issues

There are speculations now on the respective domains of payment banks and Pradhan Mantri Jandhan yojana because of overlapping nature. Moreover, it is the economies of the scheme that has drawn attention the most. Few people have criticized this idea of “Payment banks” because

1. **Nothing New under the Sun**

2. **Not 100% financial inclusion** Financial inclusion is a bigger thing than mere “payment/money transfer”. Financial inclusion means access to complete bouquet of financial services —banking, investment, insurance, pension – everything. But that’s very difficult to achieve through Payment bank system because bank cannot assume “Credit risk.

3. **Price wars**
   - Schedule commercial banks also permitted to run Payment banks through their subsidiaries. That defeats the whole purpose because SBI is a giant elephant with large resources and manpower. If it starts a payment bank then other small player’s payment banks cannot compete, and they’ll bleed in price wars.
   - So instead of allowing NBFCs and private companies to open “Payment banks” and compete with regular (commercial) banks, Nachiket should better suggest a model where they all can work in synergy to achieve 100% financial inclusion.

5. Conclusion

In next few years, there might be increased demand for Mergers and Acquisitions of Small and Mid-Sized Banks. Banking Sector may witness huge volatility and acute competition with destabilizing turmoil and struggle to survive. The idea of Payment Banks and Small Banks are unique contributions of our Central Banker which will promote Economic Development and Rural Banking in our backward economy. We can say, a revolution will take place in Indian Banking industry which will further increase Financial Inclusion in our country. Both Small and Payment Banks are the future of the Banking Sector and can easily achieve Financial Inclusion.

Some Analysts are of the view of overlapping nature of PMJDY and Payment & Small Banks. If PMJDY works out as plan, one wonder whether there will be much more space left for payment banks. Why would a customer go to payment banks that only provides deposit and payment services when he has access to a full scope bank. The Jan Dhan scheme is yet evolving. At the moment, even if conflicts with the payment banks – its a meant to reach the unbanked customers that were recommended to give fillip to financial inclusion by the Nachiket Mor committee and accepted by the RBI. Benefit of Pradahan mantra Jan Dhan Yojana and pro arguments are

- Will aid financial inclusion, will rescue villagers from the clutches of evil money lenders. You can cite those ‘disturbing numbers’ to justify your “pro” stand in the group discussion (GD) when other candidates (brainwashed by the Hindu) try to create fish market in GD by criticizing everything under the sun.
- Could boost household savings rate similar to Bank Nationalization in 1960s.
- Direct Benefit transfer (DBT) money will flow into those accounts (and from there again as “loans” to other needy people.) Thus savings will turn into capital. Subsidy leakage will decline.
- Will increase Insurance penetration.
- Overdraft only after monitoring performance => win-win, rare chances of NPA/defaults.

Whereas Payment Banks and Small Banks offering (i) small savings accounts and (ii) payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users are a means to reach a common man at distant rural locations.

Both these initiatives are complementary to each other with common vision to achieve 100% financial inclusion. Small banks will provide a whole suite of basic banking products, such as, deposits and supply of credit, but in a limited area of operation, payments banks will provide a limited range of products, such as, acceptance of demand deposits and remittances of funds, but will have a widespread network of access points particularly to remote areas, either through their own branch network or through Business Correspondents (BCs) or through networks provided by others. They will add value by adapting technological solutions to lower costs.