Financial Inclusion: Agenda for Policy Intervention

In the past three decades, there have been fundamental changes in the broad field of financial inclusion. From being an agenda that was driven from the supply side, that is, largely from the State with institutional, policy, and regulatory interventions, the field has now yielded sufficient space for the markets. After the implementation of the Pradhan Mantri Jan Dhan Yojana (PMJDY) in 2014, which aimed to give every household access to banking facilities, we are in a situation where the former Governor of Reserve Bank of India, Urjit Patel said: ‘My view about financial inclusion is probably, different from that of my predecessors. Going forward I see that the market will take over this agenda, through technology and innovation. The role of RBI will take a backseat’ (Sriram, 2018). It is in this context that we planned for a focused issue on financial inclusion. While this issue contains four articles representing diverse aspects of financial inclusion, there are more articles in the pipeline which we will be curating over the next few issues, including a roundtable on the technological innovations that make financial services accessible to the poor and the excluded.

As Patel indicates, has the role of the supply side ended? Have the markets taken over? This question is moot and the jury is not out yet. The markets for the inclusive customers are opening up. The orthodoxies of ‘subsidized services’ which made operations unviable are being challenged. At the same time, the intervention of the State in the larger interest of the poor and the vulnerable continues in different forms. The transaction and risk costs are being addressed through a series of technological innovations. We have poor and vulnerable customers who cannot absorb a shock and bootstrap themselves. The portfolio of the providers continues to have additional risks. The viability and profitability is fragile in the medium run. But still, there is an exuberance in the markets and the for-profit entities are expanding their footprint and their portfolio.

It is in this context that we constantly find the need to engage with the sector both from an enhanced understanding of the market structure and from the perspective of policy interventions. As the supply side intervention from the State is yielding space to the markets, it is important to understand the market structure. It has been a
decade since the commercialization of inclusive finance, through the establishment of commercial microfinance institutions in the for-profit sector. In the first phase, we saw that the ownership model for inclusive finance was in the not-for-profit sector. The operating model involved using social collaterals in the form of group guarantees and aggregating transactions that reduced overall transaction costs, the pricing was benchmarked at the higher-end, closer to the pricing prevalent in the informal markets. The argument of relatively high interest rate was countered by the signalling of a not-for-profit organization providing the service, thereby blunting the criticism of profiteering from the poor.

As operations stabilized, it was demonstrated that the expected risks in the model (due to inadequate documentation and collaterals) were far lesser than assumed. Therefore, it appeared that the operating model was extremely profitable. Over a period of time, the organizations held the operating model constant and changed the ownership model shifting to a for-profit format. Newer organizations also cropped up in the for-profit sector with the group-lending model. This ensured that the commercialization of inclusive finance was here to stay. However, this model was a standardized supply side model driven by enterprises rather than the State.

What happens to an extremely profitable model that is serving the hitherto excluded segments of the population? One would expect more players to come in, the competition to evolve and result in a better pricing for the consumers. It is in this background that we have an article that studies the market structure of inclusive finance. Even as this article rigorously analyses the market structure, we have seen some turbulence and policy response to the field of inclusive finance in the year 2010. The Andhra Pradesh (AP) crisis as it is famously known where the government of AP clamped down on commercial microfinance organizations was triggered by allegations of multiple agencies lending; excessive interest rates and coercive recovery practices (Sriram, 2012). The phenomenon was something strange—because with competition, the expectation is that it would result in a better deal for customers, by way of better customer services and competitive pricing. However, we saw a distortion in the market where the pricing was held almost constant, and multiple players were wooing the same customer leading to overleveraging of the customer until there was a regulatory clampdown. We now need to see if the regulatory intervention has made the sector more competitive.

The article included in this issue seems to argue that the market structure is leading to concentration of operations of the microfinance agencies as well as consolidation. The macro trends also seem to indicate the consolidation of players—banks and larger non-bank finance companies taking over microfinance entities and mergers. There seems to be a natural economy of scale making it difficult for the newer players to attract capital. What policy response does this oligopolization of the market structure require? Should it be greater consumer protection by way of anti-profiteering clauses and interest rate caps or should it result in understanding and uncluttering the entry barriers for start-ups to compete is a question we need to engage with.

In the interregnum, the State has made a proviso for differentiated banks to operate in this space. Of the 10 licences given by the RBI for these differentiated banks, 8 of
them went to erstwhile microfinance institutions. These institutions by virtue of graduating to banks have to reinvent their business model and need to engage with the clients with a bouquet of services. This is an opportunity for them to deepen their relationship with the clients. While the client space is the same as the microfinance institutions, the products on offer will have to differ—both in terms of how the products are structured and how they are administered. There is also an additional dimension, where hitherto credit-only institutions can now accept savings. In order to examine the effect of such an intervention on the overall market structure, one would have to wait a bit to see the effects of the new institutions and how they interact with the extant organizations.

While we continue the discourse on the markets taking over the inclusive finance space, we also see that the State is not withdrawing from the space completely or restricting its role to just consumer protection. Instead, the State seems to be an active participant in the space as indicated by the next two articles—one that looks at the impact of the PMJDY on the poor in urban slums and the other that looks at the politics and process of farm loan waivers. The PMJDY was the last push from the State to get households to come into the mainstream banking through a mission mode. However, the efficacy of how well the PMJDY has worked has been up for debate. The article in this volume argues that the scheme has had relative success in empowering women in the urban slums. This is an interesting finding given that unlike microfinance initiatives, PMJDY did not specifically target women. In a different context, it has been argued that opening of banking outlets had an impact on poverty in the rural areas, while those effects were not seen in the urban areas (Burgess & Pande, 2005). Given these two, the article would have some significant implications on how the policy could be framed.

While the State has intervened in inclusive space through the PMJDY scheme which implemented more than five years back, there have been no significant initiatives after the announcement and execution of PMJDY. The State has now confined itself to infusing transactions into the PMJDY accounts through benefit transfer schemes. In this context, it is quite likely that the State will largely intervene in this space only through policy and regulation rather than through institutional interventions. Even when there are new institutions, this has largely been through creating an architecture for the private sector participation. For instance, the RBI has put the licences for differentiated banks on an open platform making it possible for applicants to submit applications at a time of their convenience. The effects of this open policy are yet to be seen. The invitation for the urban co-operative banks to convert into differentiated small finance banks has seen a very lukewarm response.

In case of the other article, the question of loan waivers is always a complex issue to tackle. How does one balance between the genuine crisis in a class of assets where individual accounts are too small to have a settlement process, where this class of assets are the borrowings of the most vulnerable sections of the society having little independent voice, and the need for a healthy balance sheet which is represented by little moral hazard and credit culture. The entry of politics both in case of agriculture and in case of microfinance is essentially because the customers are seen as vulnerable and disempowered in comparison to the institutional structure they are dealing with. This is where the politics enters, as an articulation on behalf of the disposed. We can see this waiver spreading as a contagion much beyond agricultural loans and stressed regions into a political tool. Is there a need for a comprehensive policy response to stressed loans of individuals? Would an individual bankruptcy code help? These are the policy questions to be answered as we go forward.

The fourth article in this edition discusses the problem of the last mile delivery. In spite of historical experience—as evidenced by good documentation in the banking sector where Syndicate Bank had historically engaged agents for deposit collection (Agrawal, 2018) and the fact that the postal system has a vibrant extension arm of part-time postal workers in Gramin Dak Sevaks, the architecture of the last mile delivery does not seem to have taken off. There has been confusion on whether the Business Correspondents have to be individuals or corporates; whether the agencies have to be not-for-profit or for-profit entities; whether they should be exclusively handling banking operations or could do other activities; whether they should be stationary or roving; whether they should be exclusive to a bank or in the nature of white label—interoperable correspondents. The policy towards business correspondents has had many changes through the years and the basic question of their viability has not been adequately addressed. The article confirms this. Going forward, it may be essential to examine how technology may
address this issue. In the forthcoming issues, we would have a roundtable discussing the role of technology in addressing the last mile transaction problems.

These four articles address different facets of financial inclusion—looking at the physical architecture, the nature of competition, its effects on empowerment and the extraneous political architecture that intervenes in a commercial contract between the provider and receiver of financial services. All these articles lead to a larger question on how the policy architecture should evolve in this space and provides us an agenda of things to be done as well as issues to be addressed in research.

We hope you will find this issue useful. As we go along, Vikalpa has more articles in the pipeline, which we would be publishing as review process is done. We also intend to take up the issue of consumer protection as a roundtable in the future.

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