Harnessing Hidden Potential of No-frills Accounts

The no-frills bank accounts are an innovative instrument to introduce the concept of banking to the under-privileged and reduce credit rationing for this section of people. As the individual bank would have the privilege to design these no-frills accounts, the basic characteristic would involve zero or a very low balance with limited transaction facilities. Despite concerns about the servicing costs, many financial economists believe that it could be an effective instrument to combat credit rationing and provide the much-needed credit to a large section of under-privileged population in the country.

Apart from the prevalent banking policy of exclusivity, the fact that 40% of the Indian population is unbanked also suggests the problem of outreach. In some pilot areas, the distance of the bank from the customers is 15-20 kms. This translates to substantially high costs for the user to do a single banking transaction supplemented with the customer not saving a lot either. Banks that have traditionally functioned within the comfort zone of setting up brick and mortar branches are handicapped in their efforts to reach out to the masses. The role of technology in dealing with this problem and its merging with the business correspondent model of banking cannot be marginalized. Easy-to-use technological systems backed by financial literacy initiatives can add solidity to the model by servicing the last mile and greatly enhance the efficacy of no-frills accounts. Even viewed over an extensive period of time, this would prove to be more cost effective than opening up new branches.

However, on financial inclusion front, it has been reported that banks had opened more than six crores no frills accounts, but they remained cosmetic. While no-frills accounts have grown phenomenally, an important challenge before the banking system is to keep these accounts operational, as many such accounts are found to be dormant since the poor often find it difficult to save and deposit money into these accounts.

Moreover, various research studies exposes that in many districts of the country, no bank branch has extended overdraft or general credit card to any no-frills account holder. There were hardly any transactions in more than three-fourth accounts opened under the no-frills account category. The villagers still felt it is very difficult to complete transactions within a reasonable time as the bank officials are often reluctant to sanction credit facilities for their basic needs. Hence, they preferred to approach informal sources for quick credit.

However, as the no-frills accounts are expected to introduce the concept of banking to a large section of underprivileged, it will surely help the banks to create a large database of these customers. The banks can prudently use this information to target the honest customers in their databases to cross-sell various unsecured products. Moreover, the no-frills accounts, is a win-win opportunity where the banks can attract the profitable customer as a part of their unsecured campaign and a large segment of under-privileged customers gets access to the formal credit market without falling prey to the village money-lender. Now the question arises, how the banking community strategizes the no-frill account as an effective channel to acquire the potential profitable customers and prudently manages them as a part of their active Customer Relationship Management (CRM) strategy, remains to be seen.

In the meantime, the Reserve Bank of India and the government have committed to increasing financial access to 350,000 villages by 2013, covering a significant part of the 100 million households currently lacking adequate access, though they are aware that scaling up viability with quality is not at all easy. In this perspective, we highlight a few of the challenges on attaining the grand scale of financial inclusion outreach programme.

a) **Leveraging existing distribution networks:**

For "last mile" reach, banks have embarked on an effort to increase banking correspondents. But low transaction volumes are making viability difficult. Now question arises whether scaling up tie-ups between banks and post offices and co-operatives and allowing MFIs structured as non-bank finance companies to act as banking correspondents, which would help optimize capacity utilization and lower transaction costs. In this context, the government's facilitation may be needed for such integration to take place. It is also possible that covering some villages with very small population may never be viable and would require explicit or implicit subsidies.

b) **Expanding the market infrastructure**:

Credit bureaus have recently expanded coverage of informal sector MFI clients and generate over 500,000 monthly credit reports assessing client indebtedness prior to new lending. Policymakers could facilitate getting rural banks and SHGs to also share information on their borrowers with credit bureaus. Though simultaneously, better customer protection is also essential, particularly as delivery channels other than banks expand their coverage.

c) **Expanding financial product varieties**:

Recent efforts have helped create 90 million no-frills accounts, a creditable achievement as savings help manage risks, investments and cash flows. However, transaction volumes have been low. The experience with South Africa's Mzansi, a type of no-frills accounts shows that linking up with brands that clients recognize and allow the use of multiple outlets helps increase in transactions.

d) **Enabling better microfinance sector**:

SHGs and MFIs account for more small-borrower accounts than the entire banking system. Once enacted, the draft microfinance law will bring regulatory clarity and promote customer protection. Even unutilized capital can be mobilized by domestic development banks to help sustainable MFIs to scale up substantially. As for SHGs, ensuring quality of lending is essential for their long-term sustainability because pricing that reflect margins better could spur greater lending. Indeed, India's progress in its financial inclusion efforts, given the numbers and innovation involved, are of great significance.

It is here that the Reserve Bank sees opportunity garnered through no-frills accounts. As incomes grow and awareness increases, aspirations rise among the poor. Moreover, rural savings deposits tend to remain in customers' accounts. In the long run, this reduces banks' dependence on bulk deposits, minimizing the risk posed by sudden large withdrawals. The Governor stresses that some bankers will need to convert social obligations into an exciting opportunities and move aggressively on financial inclusion.

An overview of ‘No-frills’ accounts:

Indian banks, especially those in the public sector, have made substantial efforts to tap the country's rural population. But expanding through branches has been a costly and largely unsuccessful endeavor. Out of 50 public sector and private sector banks, 26 have appointed BCs, through which eight million no-frills accounts have been opened as of March 31, 2011.

Using banking correspondents is gaining in popularity globally. A recent RBI directive added six more types of correspondents, including shop owners and public call office operators to the existing categories of microfinance institutions and nongovernment organizations. In Brazil, several banks have adopted the correspondent banking model, acquiring more than 15 million accounts this way.

In India, few banks have been as active as State Bank of India, India's leading public sector bank, which has 2.5 million no-frills accounts. It has expanded through 24,000 direct agents, including thousands of non-government and microfinance organizations. From 12,000 villages in 2008, SBI now have a presence in 50,000 villages.

Migratory labor is a target, as remittances through banks make it easier to send money home. Huge sums are remitted across India, predominantly from migrant labor and more than 90% occurs through informal channels. Banks have also added more sophisticated and diverse products. For instance, some of them have products where a customer deposits a nominal amount at any one time for one to five years and at the end of the term, the customer gets principal plus interest at a fixed deposit rate of around 8%.

In the insurance space, a dual-benefit life insurance product is provided. Upon the group member's death, the beneficiary receives the benefit and upon maturity, the group member recovers half of the premiums paid over the five years. There is a provision of SIP (Systematic Investment Plan), an equity-based mutual fund plan with a minimum monthly investment of US$ 2 over at least five years. These SIP funds are invested in bigger funds, including a blue-chip fund, a balanced fund and a growth fund with a small value component to provide higher returns.

The Prices of Growth:

Despite banks' success with informal channels, reaching rural customers comes with a price tag. The main challenge, as bankers point out, lies in financial education, helping the masses to understand these products and the benefits of saving and investing. The faster the users of banking services learn of the benefits, the shorter will be the bank's gestation period in recovering its investments.

In response, financial literacy centers are being set up across India. Members of SEWA Bank, a cooperative bank established in 1974 by 4,000 self-employed women usually held three-day financial education camps in their established centres. Such centers provide individual counseling services on responsible borrowing and early savings. There are advantages on being connected to the financial sector and it is felt that there is a need for the common people to understand various financial implications.

Likewise, establishing a more highly functioning banking infrastructure will require increased investment. Presently, there is a lack of supporting infrastructure, like credit bureaus, penetration of mobile banking and biometric cards, and a national identification system. As technology is expected to be one enabler, an example of SBI's Tiny Cards concept, is a big step forward. A microchip in a smart card stores a customer profile, including photograph, fingerprint and transaction details. This scheme has been rolled out in several states in India. In 2009-10, the number of cards issued rose from 270,000 to more than 2 million and the number of no-frills accounts has doubled to 2.5 million.

SBI's Tiny Cards are connected to the network through a mobile phone or point-of-sale machine. They are used along with handheld devices with fingerprint-scanning facilities, made available to women. If used through the banking-correspondent route, nongovernment organizations and technology providers such as Financial Information Network and Operations (FINO) can bear the cost of the devices. They, in turn, can recover costs by working with banks around pre-defined service agreements. Similarly, in the state of Andhra Pradesh, 350,000 people receive money from the government through programs like the National Rural Employment Guarantee Scheme, social security and pensions, etc. Of the 2% commission SBI receives from the government for distributing these funds, it passes on 1.5% to the correspondents or the facilitators.

Bringing Life to Accounts:

For public sector banks, acquiring new accounts is not the problem. The real issue, across the industry, is deriving revenues from these accounts. As we are still a country with over a billion people where nearly half the nation is unbanked, there will be no problem on inclusion of a small charge on the customers' end to make the banking correspondents' route more viable. Indeed, the challenge for the bulk of the poor is financial services, not affordability.

For instance, funds distributed through government schemes, are rolled out into 400,000 accounts in Andhra Pradesh, while the total number of no-frills accounts acquired has crossed 1.8 million in the state. There is little or no life in accounts acquired outside such schemes; the average balance in such accounts hovers around ten rupees. Meanwhile, costs to maintain the accounts continue to rise. BCs keep up servers that interact with point-of-sale machines. The BC servers interact with a server at the bank which can cost substantially. This server, in turn, connects these accounts to the bank's core operations.

There are also operational issues like the facilitator's travel expense from branch to home and the security of funds while at residence, have yet to be resolved. Expenses mount as new accounts register and there is already a mismatch between revenues earned and costs incurred in undertaking BC operations. Banks charge BCs interest for the temporary overdraft provided to them and this adds to operating costs. Further training of BC staff involves even more outlays.

Similarly, the commission paid by banks to the BCs is not adequate for a viable business model. A majority of BCs have reported losses and some of them have even suspended their operations. This, in turn, affects the banks since it becomes difficult for banks to find substitutes. Some bold decision has to be taken in this regard. As Financial inclusion is not an end by itself, it is a means, the end being social inclusion. Banks play the role of financial intermediation and, therefore, are an important catalyst in attaining inclusive growth.

i) Benefit of no-frill accounts as source of deposits:

A recent RBI meeting with bankers and the Boston Consulting Group addressed concerns about financial inclusion. Many left with RBI Governor's firm view about the opportunity at the bottom of the pyramid: The only way to reduce costs is to increase volumes. As the country grows at 8%, job opportunities grow. As people start earning, their incomes will provide a growing **source of bank deposits** and banks that are ahead of the curve in establishing a presence in the hinterlands will likely have a first-mover advantage.

ii) Benefit of no-frill accounts as source of credit deployment:

The advisory of spreading financial inclusion through no-frill accounts can be considered a watershed development in the banking history of India as these minimum balance maintenance accounts with 'simplified KYC norms' have paved the way for financial inclusion of those who had no access to banking. The next step is to make the General Credit Card (GCC) more popular and make **credit available** to marginal farmers, landless labourers, oral lessees, self employed, unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities, socially excluded groups, senior citizens, women and people from north east.

iii) Benefit of no-frill accounts as source of MGNREGS payment:

It is obvious that the no frill accounts have achieved the partial objective for which they were opened like making **transparent wage payment** to the MGNREGS workers. A poor person has been able to open a no fill account and get his wages paid through his account than receiving cash payments which are subject to massive corruption in payments. During outreach visits to villages allotted to several banks in various states, it was found that the banks were not opening no frill accounts and wage payment were credited to those people who already had bank accounts and were getting MGNREGS payments only through them. Time has come that Banks should provide exclusive no-frill accounts where the real poor should able to draw their money without bothering about the minimum balance to be maintained in their ordinary savings bank accounts. No doubt, these massive payments will generate a surplus for the banks to make the business profitable in the near future.

iv) Benefit of no-frill accounts for making utility payments:

The other issue, which has pegged back no-frill accounts, is the fact that it is a supply side initiative and there has been no attempt either on the part of the banking industry, government or non-government agencies to build on it to create a demand for it. There has been no effort to educate the account holder about saving, using the account to **make utility payment** or doing small purchases. The no-frill account holder is a new customer. He is a poor person and has never done banking. An account has been opened for him. Now the bank has to tell him what he can do with this. Once conveyed, how he will benefit and he will start using more. Government, non-government, semi-government agencies should join hands with banks to spread financial literacy and there should be a total linkage.

v) Benefit of no-frills account-holders for promoting other services:

There is also a need to make no-frill account operation more viable so that these account holders are viable to use other services essential to them. They can be used for other services like selling insurance policy, formation of SHGs, receiving or sending remittances, etc. He needs to be incentivized for the services he wants to avail in the beginning. Since Ministry of Rural Development has agreed to pay some nominal amount per no frill account and every MGNREGS worker who puts in 15 days of work is entitled to Life Insurance policy, it is hoped that it would translate into profits too.

vi) Benefit of no-frills accounts for strengthening SHGs business:

SHGs should have some kind of incentive. They expect regular and quick payment and the banking correspondents operation is little difficult on a standalone basis. After all the challenge is to make inactive accounts active and also give other things to the unbanked. Since roughly 120 million households in the country are linked to SHGs and their deposits and outstanding loans exceed ₹ 100 billion and ₹ 300 billion respectively, it may be a good idea to transfer this business correspondents business to the SHGs. Not only will it help the SHG members to cut down their frequent travels to banks in the city but also turn the business correspondent model viable. But it is no secret that since the banking correspondents are private persons and have no institutional branding behind them, they do face credibility questions and can't altogether replace brick and mortar. People always have trust issues with them, which are not there when it comes to banking with a branch. Business correspondents still have to establish their credibility in the eyes of the farmers and a farmer does not feel comfortable in parting with his money to a Business Correspondent. Here, only SHGs can play a major role in the future.

vii) Benefit of no-frill accounts as profitable business:

More than this, the banks need to be patient when it comes to working out profitability of an account. There is a possibility that developmental activities in rural sector may take care of the non-viability factors. No-frill account per se is a **very profitable proposition**. Banks are not charging anything because they know that it has a lot of potentiality to grow into an economic activity. Many banks have found that the satellite offices they have opened in unbanked areas basically to cater poor people with hundred of no-frill accounts some years ago, have now become fit to support branch business. Many top bank executives now stresses on promotion of financial literacy on a long-term basis. Because, there is likelihood that the proposed cash transfers of subsidies to BPL families will give a boost to no-frill accounts as the unconditional transfers will empower immensely.

Concluding Remarks:

Till now, many bank envisage that opening of no-frill accounts are drag on profitability and create more harm to the existing business than facilitating growth for the future. However, with many social payments like old age pension, MGNREGS payments, payment for Indira Awas Yojana and many other schemes creating enough liquidity on the hands of hitherto down trodden people, banks have rekindled their hope that there is business in the bottom of the pyramid. Indeed, no-frill account is the first step to capture the business and the day will not be far when each bank will be competing with the rival ones to capture the no-frill account holders as there will be enough scope to turn these accounts into viable and credit worthy accounts.

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