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Role Comparison of RRBs and MFIs in financial Inclusion in INDIA

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ABSTRACT

The problem of inclusive finance is a global problem. The term financial inclusion refers to a process that ensures the feasible access, availability and convenient use of the institutionalized financial system to various cross sections of the society across the geography of a nation.

Mersland, Roy (January 2005) in his study on "The Agenda and Relevance Of Recent Research in Microfinance" highlighted that only a small part of the banking community is being reached by Micro Finance research. The lack of interaction with the banking community is notable. This raises the question if it is time to design a new research agenda, this time in cooperation with the banking community.

This paper makes an attempt to investigate the role of Regional Rural Banks (government bank) and MFIs (NGO- MFI, Co-operatives-MFI, Not for Profit NBFC-MFI, For Profit NBFC-MFI) in the states of Punjab, Haryana and Himachal Pradesh in bringing about total financial inclusion and to establish that the RRBs need to be at the forefront of the Financial Inclusion drive in Rural Areas. In the process of doing so the banks can aid the overall growth of the GDP of the country. Also, the paper suggests and recommends measures to the policy makers to help them meet the challenge of financial inclusion.

Keywords-- Financial Inclusion, MFIs, RRBs, Microfinance, Banks

I. INTRODUCTION

The term Financial Inclusion refers to a process that ensures feasible access, availability and convenient usage of institutionalized financial system across the sections of the society of a nation. It is a widely debated issue in a developing country like India, as the absence of a formal, inclusive, financial system to the poor and lack of availability of credit to the needy can and will create problems in the path of achieving a self sustaining financial system. The discussion revolves around the process and extent of wholesome inclusion of this segment of the population.

II. LITERATURE REVIEW

An inclusive financial system not only facilitates access to finance but also reduces the information and transaction costs, influences savings rates, investment decisions, government expenditure, technological innovations and the long run growth prospects (Beck, 2009). In a developing nation, the 'access to finance' is a crucial factor in enabling the people to transform their means of production and employment and to shun poverty (Banerjee and Newman, 1993).

The **World Bank**, (2008)[1] in its definition of financial inclusion, seeks broader access along with the absence of price and non-price barriers in the use of the financial services though it may be difficult to define and measure them. The **United Nations** deems it a financial sector obligation to provide "access" to credit for all bankable people and firms, to provide insurance for all insurable people with a focus on user's right to choose between the options. The **Asian Development Bank in 2000** concluded that financial inclusion or exclusion is nothing but a provision of a broad range of financial services such as deposits, payment services, money transfers and insurance to poor and low income households and their micro enterprises. ADB's research on Low Income Household's Access to Financial Services leads to the development of fundamental dimensions of access problems (depicted in Figure 1).

The Indian scenario is not different. Under the Chairmanship of Dr. C. Rangarajan, **"Committee on Financial Inclusion in India (2008)"** observed that it is a process of ensuring access to financial services and timely and adequate credit where needed, by the vulnerable groups such as weaker sections and other low income groups, at affordable cost.

The banks especially the rural development banks, the cooperative banking organizations as well as the MFIs were initially devised to help government and the Reserve Bank achieve significant financial inclusion, yet both seem to be deviating from their mandate. The initiatives are in place, yet there is no timely, local implementation.

The RBI and the Government of India have been making concerted efforts to expand banking facilities across the country. The important initiatives undertaken since independence are summarised in Table 1.

III. PROSPECTS OF RESEARCH

Despite the attention paid to Financial Inclusion and instituting policies to improve access to finance, there is a dearth of information regarding 'access to finance'. The problem of inadequate information is compounded by the fact that access does not always lead to usage.

Mersland, Roy (January 2005) in the study "The Agenda and Relevance Of Recent Research in Microfinance" highlighted that only a small part of the banking community is being reached by Micro Finance research. The study shows that the researchers mainly interact with the donor' and practitioners' communities and consequently the research produced seems to be relevant for them and less so for the government and banking communities. The lack of interaction with the banking community is notable. This raises the question if it is time to design a new research agenda, this time in cooperation with the banking community.

This knowledge gap poses a significant challenge in designing effective policy interventions. The study proposes to present useful insights to the policy makers by critically assessing what has been done in this field. The contribution of the research work is enumerated below:

- Relevant research for the government banking institutions
- Development of effective marketing orientation
- Policy correction
- Generating inputs for academic debate resulting in innovative methods to achieve Financial inclusion
- Providing direction and approach to Financial Inclusion

IV. OBJECTIVES OF THE STUDY

This paper makes an attempt to investigate the role of Regional Rural Banks (government bank) and MFIs (NGO- MFI, Co-operatives-MFI, Not-for-Profit NBFC-MFI, For Profit NBFC-MFI) in bringing about total Financial Inclusion and to establish that the RRBs need to be at the forefront of the Financial Inclusion drive in Rural Areas. In the process of doing so the banks can aid the overall growth of the GDP of the country. Also, the paper suggests and recommends measures to the policy makers to help them meet the challenges of Financial Inclusion.

V. STUDY AREA

The study was conducted in three contiguous states of Northern India viz. Punjab, Haryana and Himachal Pradesh. The Rural Household coverage under SHG- Bank linkage programme was less than 20 per cent in Punjab and Haryana and less than 50 per cent in Himachal Pradesh (refer to Table 2).

VI. RESEARCH METHODOLOGY

Based on the objectives of the research and the theory reviewed, the following Null Hypothesis has been formulated.

VII. HYPOTHESES

H_{01}: There is no difference in the volumes of business of MFIs and RRBs.
H_{02}: There is no difference, even after RRBs mobilize rural savings, in the growth of overall GDP of the country.

VIII. SAMPLING DESIGN

- ***POPULATION FOR THE STUDY**:* The population for the study consists of the MFIs and RRBs in India which provide Microfinance and all the people who have availed Microfinance from either MFIs or RRBs.
- ***SAMPLING METHOD:*** The sample from the population is drawn at the convenience of the researcher, from the area of study - states of Punjab, Haryana and Himachal Pradesh in North India.
- ***SAMPLE SIZE:*** Two types of lending institutes – Micro Finance Institute and Regional Rural Bank – encompassing private and government sector respectively, are selected for the study. To cover the lenders 30 branches are surveyed from each state (15 MFIs and 15 RRBs). A sample of 300 respondents (50 MFI beneficiaries and 50 RRB beneficiaries i.e. 100 respondents from each state) are chosen for supporting the study from the borrowers perspective.

IX. DATA COLLECTION INSTRUMENT

The primary source of data collection was a questionnaire and discussions with experts in the field of Microfinance, whereas secondary sources were electronic and physical publications like (National Sources) RBI, NABARD, reports of various committees, National Sample Survey Organization (NSSO), National Accounts Statistics of Central Statistical Organization (CSO) and other apex level (International) organizations and World Bank, Commonwealth institutes. The Researcher's own observations and personal Judgments have substantiated the primary data.

X. DATA ANALYSIS TOOL

Two statistical tools - percentage and Chi square test - are used to analyse the data collected and collated.

XI. RESULTS AND DISCUSSIONS

Hypothesis testing was done using the primary data and supported by the secondary data and information.

H_{01}: There is no difference in the volumes of business of both MFIs and RRBs.

We want to establish that the MFIs are doing more business than RRBs. However, the RRBs should emerge as the dominant player in the rural market and should be at the fore front of Financial Inclusion drive.

To examine this hypothesis, the questionnaire for the beneficiaries included questions like: How did they become aware of Microfinance, whom do they prefer taking loans from (MFIs, RRBs, Money lender etc.), does the loan giving agency approach them, what is time taken to sanction and disburse the loan, the, extent of overseeing the enterprise after the loan is given, helping capacity building etc...

The graphical analyses of the answers are presented at the end of the chapter and the theoretical interpretation is provided here.

The beneficiaries' preference of lending agencies, among the available options, is represented in the Figure 2. In shows that more RRB beneficiaries want to go to the money lender than the MFI beneficiaries.This reduces the RRBs volume of transaction, among other things. And hence supports in rejecting the null hypotheses H_{01}.

The proportion of prospective clients who approach the agency for loan among MFI and RRB beneficiary was significant at .01 levels, as MFIs are more proactive in giving loans compared to the RRBs.

Distribution of accounts under MGNREGA between MFI and RRB Beneficiary (Table 3) shows an interesting result - in spite of having accounts under MGNREGA the loan (Microcredit) has been taken from the MFIs and this does not augur well for the RRBs business, supports in rejecting null hypotheses H_{01}.

Even where accounts have been opened, about 80 per cent-90 per cent are inactive, as shown by three independent studies conducted in three different parts of the country by Microsave, Centre for Microfinance Research, and Skoch. Villagers do not operate the accounts and RRBs, citing a poor business case, do not dive in either. Such tentative adoption of bank accounts has serious ramifications for an ongoing transition - direct transfer of Rs 3trillion of benefits like food and fertiliser subsidies and government schemes into bank accounts[2] - which the government sees as a game-changer in the delivery of welfare programmes.

The volume of MFI business is also high because they can disburse only microloans and thus all their clients are MF beneficiaries whereas the RRBs have the mandate for handling other financial instruments besides microloans, thus less than 30 per cent of RRBs total loans are disbursed as Microloans. Though RBIs Financial Inclusion drive lays out a roadmap to achieve the target, RRBs need to revisit their strategy to achieve this target.

The volumes are also low because service providers in the lending ecosystem face hurdles. The major challenges can be surmised as follows:

- Identity check when lending to rural population
- Tackling the social stigma associated with undertaking credit as means to growth
- Establishing the bankability of the genuine desirers of credit
- Decisions regarding loan sanctioning
- Inherent illiteracy and ignorance regarding financial matters and saving
- Ensuring profitability of the loan usage and generation of loan repayment
- Tackling instances of monetary fraud and instances of misrepresentation
- Ensuring compliance to guidelines
- Ensuring marketability of loan undertaken

Some of the above mentioned challenges - like distance, location constraints, non-availability of talented work force, and lack of adequate information - which are similar for RRBs and MFIs, can be met with technology interventions. .

Information and Communication Technology (ICT) can enable an inclusive banking model and provide comprehensive solutions covering both the front-end and the back-end operations. It can also provide an easy and secure interface for the rural people with biometric security measures.

The result of the analysis being significant at .01 and .05 level, (Table 3) shows that Technology certainly helps the service providers (Private-MFIs and government RRBs) to move up the value chain, reaching out and supporting a larger population of a specified area or geographic location. The traditional methods of brick and mortar bank branch should be replaced by the more modern banking i.e. branchless banking, and the banking correspondent model can give way to mobile banking and credit disbursal platforms, thus' taking banks to peoples home', in Mohamad Yunus words.

Thus the conclusion is that MFIs have more volume of Microfinance business compared to RRBs and there exists a potential for RRBs to do increase their Microfinance business.

An important inference from Hulme and Mosley's (1996) cross-country study of rural credit institutions was that in India, RRBs incurred the lowest cost of administration at 8.1 per cent of the total portfolio. It was concluded by V.K. Ramanchandran and Madhura Swaminathan (2001), International Labour Office, Geneva, Oct 2001 in their paper "Does informal credit provides security? Rural Banking Policy in India" that transferring the task of serving the credit needs of rural borrowers from the banking system to NGO-controlled microcredit projects does not reduce transactions costs but, in effect, transfers transactions costs - higher transactions costs - to donors as well as borrowers. We see in this study that any kind of microcredit organization (MFIs) will make the cost of credit expensive for the borrowers. And thus the RRBs should be in the forefront of the Microfinance work.

Primary data collected from the RRBs and MFIs also shows that most RRBs used a very small percentage of resources, about 4 per cent, in disbursing micro loans and advances, while more than three-fourths of the MFIs used more than 5 per cent of the resources in disbursing such loans and advances (Table 5). Since a higher number of RRBs beneficiaries wanted to go to money lender than the MFI beneficiaries (table 6) thus not citing a good case of business offerings by the RRBs.

Null Hypothesis 1 thus stands rejected. MFIs have larger volume of business than RRBs.

H_{02}: There is no difference, even after RRBs mobilize rural savings, in the growth of overall GDP of the country.

To examine this hypothesis, let's start with some of the following observations[3]

- The Reserve Bank of India (RBI) in 2009 set time-bound targets and assigned banks to reach the unbanked, who were estimated at 480 million and mostly living in India's 630,000 villages.
- It said that all 72,800 villages with a population of above 2,000 should have banking access by March 2012 and all 348,000 villages with a population of above 1,000 by March 2013 or about 70 per cent of villages covered. The aggregate numbers look impressive by the end of first target date i.e. March 2012.
- RBI data shows that the number of villages covered has doubled to 107,000 and the number of bank accounts has grown 60 per cent to 80 million. Banks did not open branches and relied on their roving representatives banking correspondents (BC) to cover three out of four new locations.

The beneficiaries were asked what percentage increase in their saving do they attribute to being members of SHGs. The statistics are represented in Table 7. It shows that 88.8 per cent of MFIs attributed less than 30 percent increase in saving to SHGs membership and 84.4 per cent RRBs attributed it to SHGs.

Though the question on savings pertains only to RRBs, since MFIs do not have the mandate to deposit savings, it is the considered opinion of MFIs that their clients have developed the habit of saving, thus securing their future and that of the economy. The multiplier effect will thus lead to an increase in GDP.

There is substantial difference, after banks mobilizes the rural savings, in the growth of overall GDP of the country.

RRBs (as banks) can mobilize savings the MFIs are left with no option but to seek financial support from other formal sources of finance. Yet, the banks have failed to achieve financial inclusion, at least to the desired extent, if not 100 per cent.

The Null Hypothesis thus stands rejected. Financial Inclusion will clearly bring about the growth in over all GDP of the country.

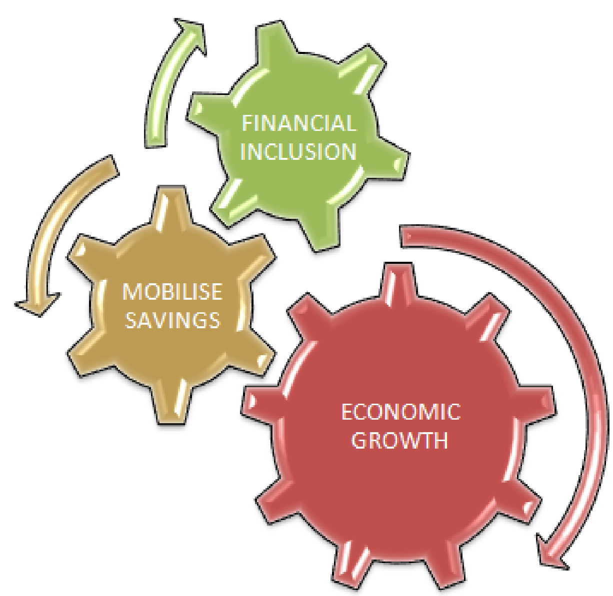
After examining the above hypothesis it can be concluded that while both MFIs and RRBs are trying to fulfil the RBI mandate of greater financial inclusion, there is a difference in their approach towards the customers. As a result the volume of business and the impact of the schemes on the beneficiaries are different for the two lending institutes examined by the study. The data and hypotheses also lead to a few findings and recommendations elaborated in the following paragraphs.

XII. FINDINGS AND RECOMMENDATIONS

The findings from the rejection of null hypotheses highlight the fact that MFI beneficiaries gain more from the association than RRB beneficiaries. Due to this the volume of Microfinance business is more for MFIs than RRBs. Underlying this, is the fact that MFIs engage more with their beneficiaries and handhold them through the entire tenure of the loan, engaging in non-financial intermediation like capacity building, business development activity etc, consequently having a positive impact on their standard of living.

The key finding is that there will be a substantial difference, after RRBs mobilize rural savings, in the growth of overall GDP of the country. The process of financial Inclusion drives the savings and contributes in growth of overall GDP of the country. From this emerges a workable model of mutually beneficial approach towards feasible financial inclusion. Volume generation, crucial for internal and external motivation of stakeholders and key to achievement of RBI's goals, is possible with development of awareness, loan options and disbursal time and the personal participation of employees across the financial institutions. This calls for optimum, comprehensive and inclusive regulatory framework. The impact on the rural households across gender lines, shaping of financial behaviour with post consumption counselling is evident and the savings and their multiplier effect on GDP are significant.

XIII. THE PROPOSED MODEL



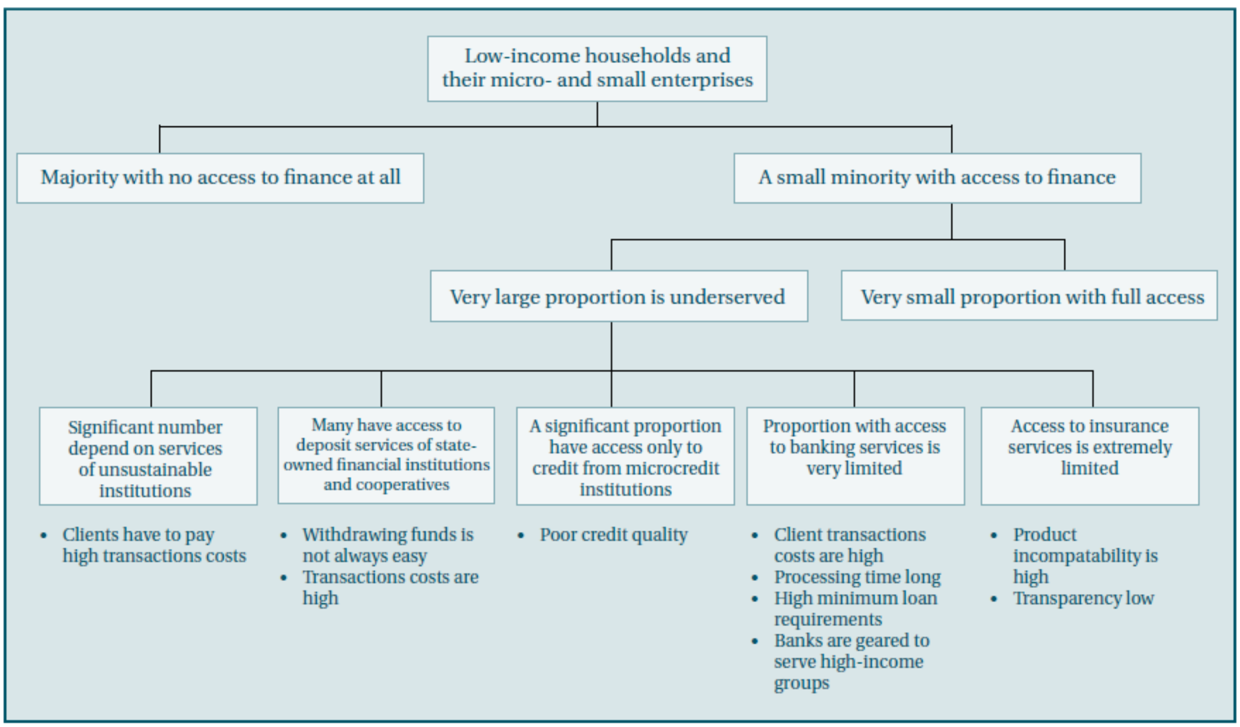
XIV. RECOMMENDATIONS

The main recommendations from this research task are summarized here.

- Financial Inclusion efforts need to win the trust of the rural people and make them think about money management. The direct cash transfer scheme will make it compulsory for the rural households to open bank accounts or opt for no-frills banking relations. The compulsion will, in turn, help the institutions scale up and move ahead on the financial inclusion mission. This cash flow can be exploited for the growth of the nation only if government institutions, RRBs, expand their branch network, train their employees and win the beneficiaries' trust leading to their own growth.
- Changes are needed in the product and ways of approaching the target rural population. The overall perspective of the rural marketing approach needs to be developed i.e. growth hand-in-hand with increase in basic standard of living.
- Since there is continuous change in the Technological environment, Financial Infrastructure and Institutions, Information & Communication Technology, developing schools for innovating a delivery mechanism (of financial product) that suits a culturally and geographically diverse country like India is needed. Effective market orientation is about periodic adjustment to changing market realities and consumer aspiration. Other requirement is to remain ahead of competitors as well as putting the customer in centre.

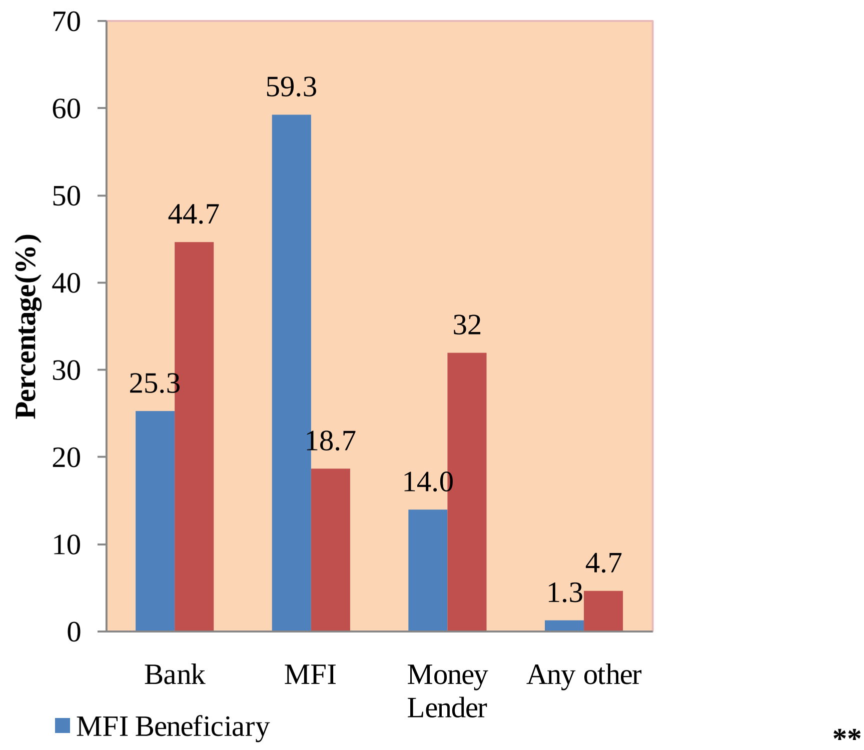
Figures and Tables

Figure 1: Dimensions of the Access Problem



Source: ADB (2007)

Figure 2: Distribution of Options to Beneficiaries While Taking Loan (χ^2 =53.2 and p value=0.00)



**significant at .01 level

Table1: Timeline of Banking Initiatives to Facilitate the Financial Inclusion

Year	Initiative
1955	Creation of State Bank of India
1969 & 1980	Nationalization of Commercial Banks
1970	Introduction of Lead Bank Scheme
1975	Establishment of Regional Rural Banks (RRBs)
1992	Self-Help Group (SHG)-Bank Linkage Programme
2001	Kisan Credit Card Scheme
2005	Introduction of "No-Frill" accounts

Table 2: Frequency Distribution Of Rural Household Coverage Under SHG-Bank Linkage Programme

Rural Household Coverage Range (per cent)	Number of States within the range	States
0-20	9	Bihar, Haryana, J&K, Jharkhand, M.P, Nagaland, Punjab, Sikkim, and Uttar Pradesh
21-50	10	Arunachal Pradesh, Assam, Chhattisgarh, Delhi, Gujarat, HP, Manipur, Meghalaya, Rajasthan, and Uttaranchal
51-75	5	Lakshadweep, Maharashtra, Mizoram, Tripura and West Bengal
76-100	2	Goa and Orissa
>100	7	Andaman & Nicobar Island, A.P, Chandigarh, Karnataka, Kerala, Pondicherry and Tamil Nadu

Source: Status of Microfinance in India, Nabard, 2010-11

Table 3: Distribution of accounts under MGNREGA

	MFI Beneficiar	**Bank Beneficiar**	**Chi-Square**	**df**	**P value**
Yes	**119(79.3)**	**82(54.7)**	**20.6**	**1**	**0.00****
No	**31(20.7)**	**68(45.3)**			
Total	**150(100)**	**150(100)**			

Table 4: Role of ICT in Financial Inclusion

Question	**Chi-square value**	**P value**
ICT among MFI and Bank	8.78	0.00**
Use of ICT help in reducing the operational cost among MFI and Bank in 2010-11	8.8	0.01*
Distribution of ICT help in handling the volume of transaction among MFI and Bank in 2010-11	2.58	0.09

* Significant at 0.05 level
** Significant at .01 level

Table 5: Percentage of resources used for extending loans & advances by MFI and RRB in 2010-11

	MFI N(%)	Bank N(%)	Chi-square	Df	p value
Less than 2%	0(0.0)	9(20.0)	61.01	4	0.00**
2-3%	0(0.0)	9(20.0)			
3-4%	5(11.1)	11(24.4)			
4-5%	5(11.1)	16(35.6)			
More than 5%	35(77.8)	0(0.0)			
Total	45(100.0)	45(100.0)			

** Significant at 0.01 level

Table 6: Distribution of beneficiary preference for taking loans

	MFI Beneficiary	Bank Beneficiary	Chi-Square	Df	P value
Bank	38(25.3)	67(44.7)	53.2	3	0.00**
MFI	89(59.3)	28(18.7)			
Money Lender	21(14.0)	48(32.0)			
Any other	2(1.3)	7(4.7)			

**Significant at 0.01 level

Table 7: Distribution of percentage of increase in saving attributed to the SHGs among MFI and RRB

Increase attributed to SHGs	MFI N (%)	Bank N (%)	Chi-square	df	P value
None	5(11.2)	0(0.0)	12.1	2	0.00**
Less than 30%	40(88.8)	38(84.4)			
30-50%	0(0.0)	7(15.6)			
Total	45(100.0)	45(100.0)			

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