PAYMENT BANKS A LEAP TOWARDS FINANCIAL INCLUSION

Mrs.M.K.Soumiya Devi[1], Dr. Kavitha Shanmugam[2], Dr.J.Ramya[3]

[1]B.E, M.B.A, SET, Asst Prof.

[2]M.B.A, M.Phil, SLET, NET, Ph.D, Asst Prof (Sl.Gr)

Mba Department, Easwari Engineering College, Chennai, Tamil Nadu (India)

[3]Asst Prof. Mba Department Easwari Engineering College, Chennai, Tamil Nadu, (India)

ABSTRACT

The paper discusses the concept and need for financial inclusion and how the payments banks would enable financial inclusion in India. It offers information on the various initiatives taken by the Indian government to foster the process of financial inclusion and the significance of digitalisation of payments for the Indian economy. It compares the level of financial inclusion of the BRICS countries with that of USA using financial inclusion indicators. The paper concludes by highlighting the employment of G20 principles in India through payments banks.

I. PAYMENT BANKS A LEAP TOWARDS FINANCIAL INCLUSION

The term "Financial Inclusion" has gained importance since the early 2000s, a result of findings about financial exclusion and its direct correlation to poverty. The United Nations defines the goals of financial inclusion as follows:

- Access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance;
- Sound and safe institutions governed by clear regulation and industry performance standards;
- Financial and institutional sustainability, to ensure continuity and certainty of investment; and
- Competition to ensure choice and affordability for clients.

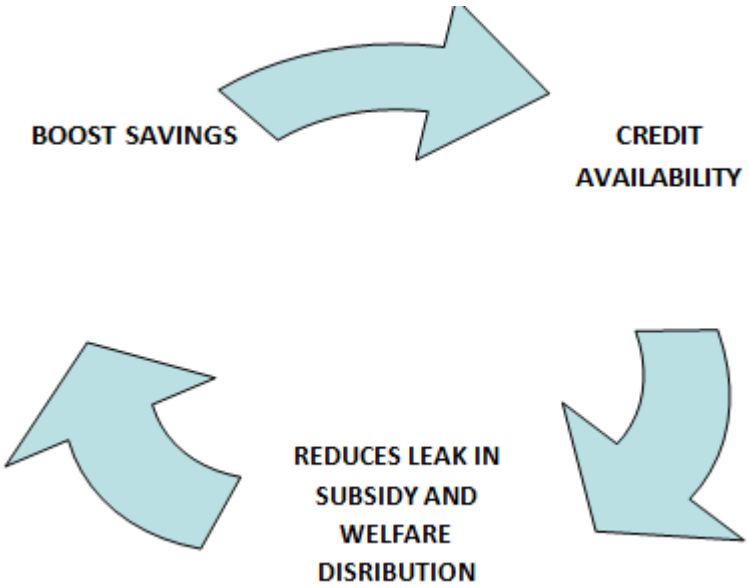
Former United Nations Secretary-General Kofi Annan, on 29 December 2003, said,"The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector. Together, we can and must build inclusive financial sectors that help people improve their lives." More recently, Alliance for Financial Inclusion (AFI) Executive Director Alfred Hannig highlighted on 24 April 2013 progress in financial inclusion during the IMF-World Bank 2013 Spring Meetings: "Financial inclusion is no longer a fringe subject. It is now recognized as an important part of the mainstream thinking on economic development based on country leadership.

The policy makers have been focusing on financial inclusion of Indian rural and semi-rural areas primarily for three most important pressing needs:

1. **Creating a platform for inculcating the habit to save money** – The lower income category has been living under the constant shadow of financial duress mainly because of the absence of savings. The absence of savings makes them a vulnerable lot. Presence of banking services and products aims to provide a critical tool to inculcate the habit to save. Capital formation in the country is also expected to be boosted once financial inclusion measures materialize, as people move away from traditional modes of parking their savings in land, buildings, bullion, etc.

2. **Providing formal credit avenues** – So far the unbanked population has been vulnerably dependent of informal channels of credit like family, friends and moneylenders. Availability of adequate and transparent credit from formal banking channels shall allow the entrepreneurial spirit of the masses to increase outputs and prosperity in the countryside. A classic example of what easy and affordable availability of credit can do for the poor is the micro-finance sector.

3. **Plug gaps and leaks in public subsidies and welfare programmes** – A considerable sum of money that is meant for the poorest of poor does not actually reach them. While this money meanders through large system of government bureaucracy much of it is widely believed to leak and is unable to reach the intended parties. Government is therefore, pushing for direct cash transfers to beneficiaries through their bank accounts rather than subsidizing products and making cash payments. This laudable effort is expected to reduce government's subsidy bill (as it shall save that part of the subsidy that is leaked) and provide relief only to the real beneficiaries. All these efforts require an efficient and affordable banking system that can reach out to all. Therefore, there has been a push for financial inclusion.



Government initiatives towards financial inclusion

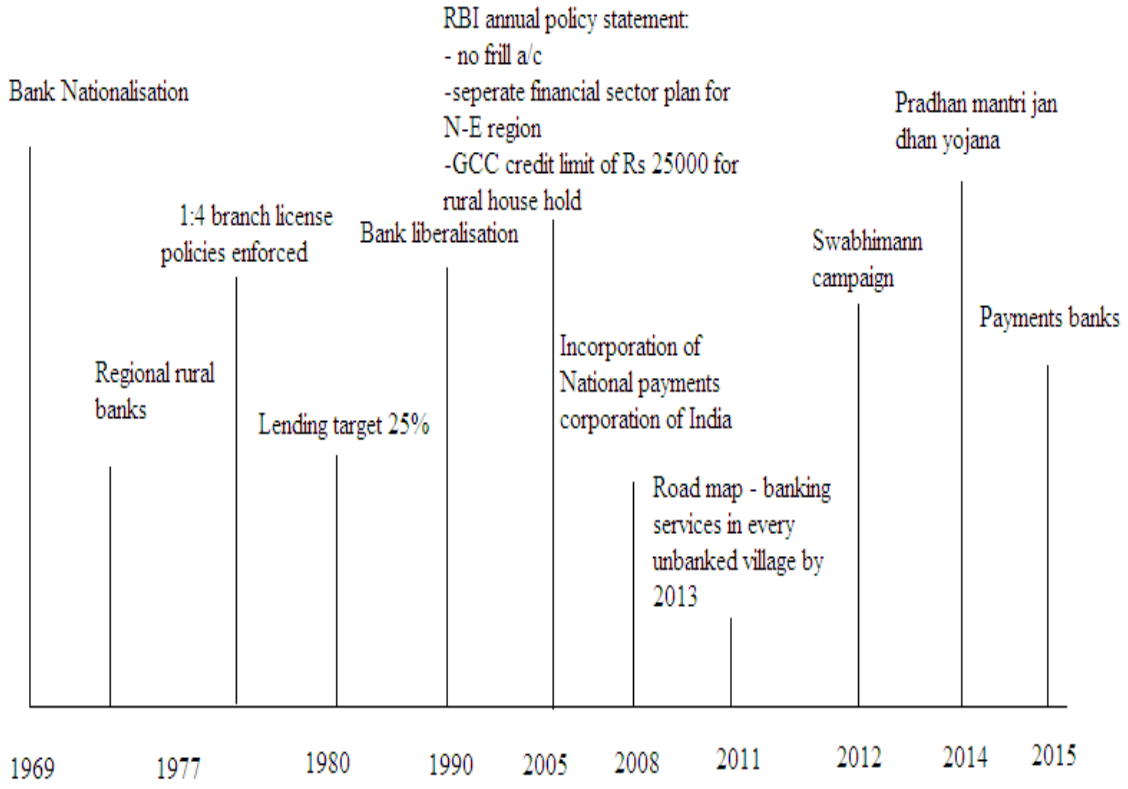
National Payment Corp of India, Reserve Bank of India, after setting up of the Board for Payment and Settlement Systems in 2005, released a vision document incorporating a proposal to set up an umbrella institution for all the RETAIL PAYMENT SYSTEMS in the country. The core objective was to consolidate and integrate the multiple systems with varying service levels into nation-wide uniform and standard business process for all retail payment systems. The other objective was to facilitate an affordable payment mechanism to benefit the common man across the country and help financial inclusion.

IBA's untiring efforts during the last few years helped turning this vision a reality. National Payments Corporation of India (NPCI) was incorporated in December 2008 and the Certificate of Commencement of Business was issued in April 2009. It has been incorporated as a Section 25 company under Companies Act and is aimed to operate for the benefit of all the member banks and their customers. The authorized capital has been pegged at Rs 300 crore and paid up capital is Rs 100 crore so that the company can create infrastructure of large dimension and operate on high volume resulting payment services at fraction of the present cost structure.

'Swabhimaan' – a financial security programme was launched by the Central Government to ensure banking facilities in habitation with a population in excess of 2000 by March 2012. This nationwide programme on financial inclusion was launched in February, 2011 with its focus on bringing the deprived sections of the society in the banking network to ensure that the benefits of economic growth reach everyone at all levels.

In a big nation like India, providing banking facilities across the length and breadth of the country, especially in rural areas, has always been a great challenge for the successive governments since Independence. Even though nationalization gave a big boost to expansion of banks in rural areas with Public Sector Banks becoming important instruments for advancement of rural banking and changing lives of rural populace.

II. TIMELINE OF GOVERNMENT INITIATIVE TOWARDS FINANCIAL INCLUSION



Pradhan Mantri Jan Dhan Yojana is National Mission for Financial Inclusion to ensure access to financial services, namely Banking Savings & Deposit Accounts, Remittance, Credit, Insurance, Pension in an affordable

manner. This financial inclusion campaign was launched by the Prime Minister of India Mr. Narendra Modi, on 28 August 2014 He had announced this scheme on his first Independence Day speech on 15 August 2014

Run by Department of Financial Services, Ministry of Finance, on the inauguration day, 1.5 Crore (15 million) bank accounts were opened under this scheme. Guinness World Records Recognises the Achievements made under PMJDY, Guinness World Records Certificate says "The most bank accounts opened in 1 week as a part of financial inclusion campaign is 18,096,130 and was achieved by Banks in India from 23 to 29 August 2014". By 05 August 2015, 17.45 crore accounts were opened, with around Rs 22032.68 crore (US$3.3 billion) were deposited under the scheme.

Record Number of 11.50 Crore Bank Accounts Opened Under Pradhan Mantri Jan Dhan Yojana (PMJDY) as on 17th January 2015 against the original Target of 7.5 Crore by 26th January, 2015.

Pradhan Mantri Jan - Dhan Yojana (Accounts Opened As on 05.08.2015) (All Figures in Crores)

S.No		No Of Accounts			No Of Rupay Debit Cards	Balance In Accounts	% of Zero Balance Accounts
		Rural	Urban	Total			
1	Public Sector Banks	7.48	6.16	13.64	12.54	17273.12	45.75
2	Regional Rural Banks	2.65	0.46	3.11	2.27	3684.56	48.55
3	Private Banks	0.41	0.28	0.7	0.62	1075.01	45.71
	Total	10.55	6.9	17.45	15.43	Rs 22032.68 crore (US$3.3 billion)	46.25

Source: Department of financial services, Govt of India

III. PAYMENT BANKS

A payments bank is a type of non-full service niche bank in India. A bank licensed as a payments bank can only receive deposits and provide remittances. It cannot carry out lending activities. This type of bank was created to help India reach its financial inclusion targets. This type of bank is targeted at migrant labourers, low income households, small businesses, and other unorganised sector entities. The customers can deposit and withdraw money, use cheque books, ATMs, transfer funds , buy mutual funds and insurance from payments banks.

The bank should be fully networked from the beginning. The bank can accept utility bills. It cannot form subsidiaries to undertake non-banking activities. Initially, the deposits will be capped at Rs 1,00,000 per customer, but it may be raised by the RBI based on the performance of the bank. The bank cannot undertake lending activities. 25% of its branches must be in the unbanked rural area. The bank must use the term "payments bank" to differentiate it from other types of bank. The banks will be licensed as payments banks under Section 22 of the Banking Regulation Act, 1949 and will be registered as public limited company under the Companies Act, 2013.

On 2015, RBI released the list of entities which had applied for a payments bank licence. There were 41 applicants. It was also announced that an external advisory committee (EAC) headed by Nachiket Mor would evaluate the licence applications. On 28 February 2015, during the presentation of the Budget it was announced that India Post will use its large network to run a payments bank. The external advisory committee headed by Nachiket Mor submitted its findings on 6 July 2015. The applicant entities were examined for their financial track record and governance issues.

On 19 August 2015, the Reserve Bank of India gave "in-principle" licences to eleven entities to launch payments banks:

1. Aditya Birla Nuvo
2. Airtel M Commerce Services
3. Cholamandalam Distribution Services
4. Department of Posts
5. FINO PayTech
6. National Securities Depository
7. Reliance Industries
8. Dilip Shanghvi, founder of Sun Pharmaceuticals
9. Vijay Shekhar Sharma, CEO of Paytm
10. Tech Mahindra
11. Vodafone M-Pesa

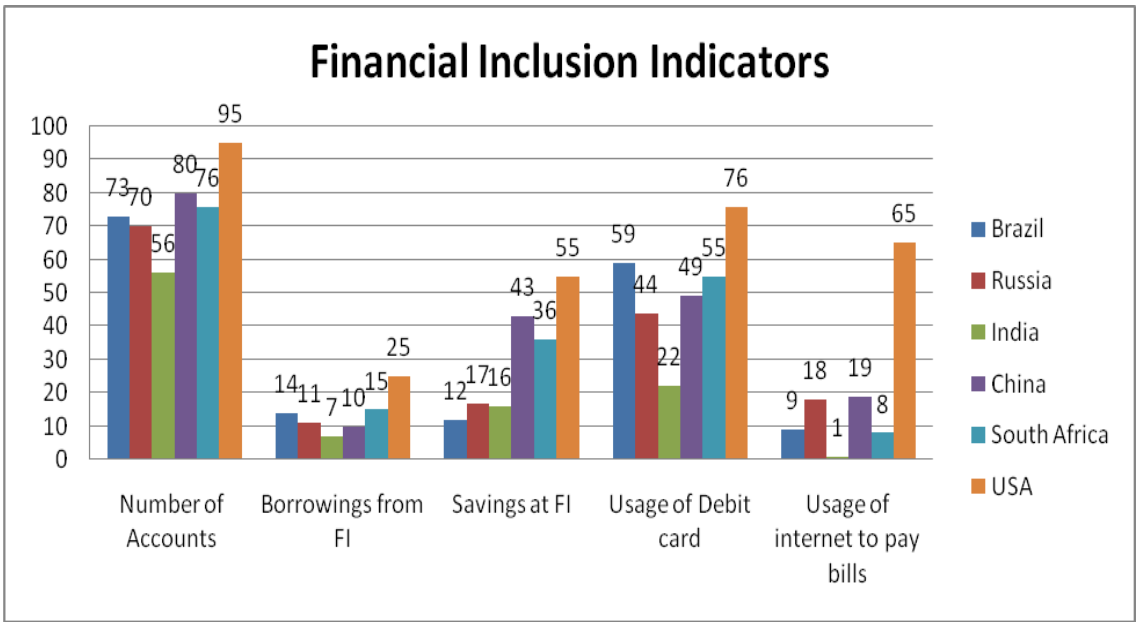
The "in-principle" licence is valid for 18 months within which the entities must full fill the requirements. They are not allowed to engage in banking activities within the period. The RBI will consider grant full licences under Section 22 of the Banking Regulation Act, 1949, after it is satisfied that the conditions have been fulfilled.

IV. FINANCIAL INCLUSION INDICATORS

Financial inclusion indicators can be used to help set national financial inclusion targets and monitor progress in reaching them. When policymakers have reliable performance indicators and survey mechanisms, they can:

- diagnose the state of financial inclusion
- agree on targets
- identify barriers
- craft policies and
- monitor and measure policy impact

Country-level data and diagnostic assessments inform the design and help sequence reforms. The same data also helps the private sector improve the design and delivery of financial services.



Source: databank.worldbank.org

According to the World Bank data 2014, based on the five indicators namely, number of accounts, borrowings from financial institution, savings at financial institution, usage of debit card and usage of internet to pay bills, USA which is a developed country leads the BRICS countries in the level of financial inclusion. Among the BRICS countries the level of financial inclusion of India is considerably low.

The main types of indicators to consider when measuring financial inclusion are:

- Access indicators reflect the depth of outreach of financial services, such as the penetration of bank branches or point of sale (POS) devices in rural areas, or demand-side barriers that customers face to access financial institutions, such as cost or information.
- Usage indicators measure how clients use financial services, such as the regularity and duration of the financial product/service over time (e.g. average savings balances, number of transactions per account, number of electronic payments made).
- Quality measures describe whether financial products and services match clients' needs, the range of options available to customers, and clients' awareness and understanding of financial products.

V. BENEFITS OF DIGITALISING PAYMENTS

5.1 Benefits for Governments when they Digitize Payments

Increased transparency given the liquidity and transactional anonymity of cash, cash payments are subject to "leakage" (payments that do not reach the recipient in full) and "ghost" (fake) recipients, particularly in the context of government transfers. By moving toward digital payments, the traceability of the payment process is improved. First, recipients have digital records of the amount of the payments they are to receive.

Second, digital payments generally require more stringent identification documentation, making it harder for ghost recipients to remain undetected. Evidence from India shows that making social security pension (SSP) payments digitally via smart cards compared to manual cash payout at the village level by a government official results in a 1.8 percentage point lower incidence of bribe demands for obtaining the payment (compared to an

incidence of 3.8 percentage points for manual cash payments: a 47 percent reduction) and the incidence of ghost recipients fell by 1.1 percentage points

Based on the study by the world bank in 2014 it has been proposed that digital payments is vital for economic growth

– Integrating digital payments into the economies of emerging and developing nations addresses crucial issues of broad economic growth and individual financial empowerment, according to a new report by the World Bank Development Research Group.

The report examines, for the first time, growing evidence from around the world about how digital payments offer immediate benefits for both senders and receivers in developing economies, as well as the ability of such payments to increase citizen access to affordable financial tools. The report also highlights how digital payments help increase the financial independence of women by moving them from the limitations of a cash-only economy and connecting them with the financial mainstream.

Furthermore, the report concludes that the establishment of digital payments for remittances instead of cash is of enormous benefit to poor people in emerging markets and also contributes to financial development. This could also help address concerns about the transparency and traceability of remittances.

"The benefits of digital payments go well beyond the convenience many people in developed economies associate with the technology," said Dr. Leora Klapper, Lead Economist at the World Bank Development

The report presents an action plan for governments to adopt to realize the benefits of digital payments. Specific calls to action include:

1. Digitize government payments and receipts, including social transfers. This creates a foundation upon which the private sector can build, including for person-to-person payments, such as international and domestic remittances.
2. Engage actively on the regulatory agenda. Governments need to encourage regulators to enable digital financial services by fostering competition, ensuring consumer education and fostering business model innovation.
3. Convene public and private sectors to create a basic technical payment platform infrastructure, across which providers can compete on product development. Public and private sectors can converge around a payments platform, and enable innovation and competition in additional financial services.
4. Create an enabling environment that fosters private-sector innovation. Governments need to offer a clear vision and tangible incentives in order to ensure that the private sector is an effective, competitive, transparent, and efficient partner.
5. Recognize the role of remittance providers in offering a digital entry point to formal financial services for senders and receivers. Instead of remittances being cashed out, remittances sent to a bank account, e-wallet, or smart card, for example, can go into accounts that support safe saving and also increase transparency and traceability.

5.2 G 20 Principles for Innovative Financial Inclusion

The Principles were developed in 2010 by the Access through Innovation Sub-Group (ATISG) of the G20 Financial Inclusion Experts Group (FIEG).

Principle 1: Leadership:

Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.

Principle 2: Diversity

Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.

Principle 3: Innovation

Promote technological and institutional innovation as a means to expand financial system access and usage, including addressing infrastructure weaknesses.

Principle 4: Protection

Encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers, and consumers.

Principle 5: Empowerment

Develop financial literacy and financial capability.

Principle 6: Cooperation

Create an institutional environment with clear lines of accountability and coordination within government; and also encourage partnerships and direct consultation across government, business, and other stakeholders.

Principle 7: Knowledge

Utilize improved data to make evidence-based policy, measure progress, and consider an incremental "test and learn" approach by both regulators and service providers.

Principle 8: Proportionality

Build a policy and regulatory framework that is proportionate with the risks involved in such innovative products and services, and is based on an understanding of the gaps and barriers in existing regulation.

Principle 9: Framework

Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk based AML/CFT regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market based incentives to achieve the long term goal of broad interoperability and interconnection.

5.4 Payment Banks – Employing the G20 Principles

The payment banks encompass certain principles advocated by the G20 countries with the objective of fostering financial inclusion of India. The government since 2014 has introduced "Pradhan matri jan dhan yojana "as the first step towards financial inclusion. Following the record breaking success of the pradhan matri jan dhan yojana our committed government has introduced the concept of payment banks, granting licence to 11 top corporate to function as payment banks for the next 18 months and monitor its progress.

As quoted by the RBI governor these 11 new payment banks will be useful as they could bring players into the system, thereby reducing the cost of accessibility and thus serve as a feeder to the universal banks.

With technological innovation such as usage of ordinary mobile phones to transfer money, easing the process of money transaction even for the basic domestic purposes like payment to the milk man etc, the payment banks are a boon especially to the unbanked customers.

Though the mechanism of money transaction is eased the safety of the deposits is also taken into consideration as the customers are provided with unique passwords to carry out the transaction

In India with the smart launch of national payments corporation of India there are alternative networks such as Ru pay and IMPS which are running at low transaction cost supporting the digitalisation of cash transactions.

The postal department is open to partnerships with other entities which got a payments bank licence with clear lines of accountability and coordination.

As the payment banks acts as a major step towards following the G20 principles to attain better financial inclusion they are expected to be a game changer in shaping up the Indian economy

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