An Overview of Financial Service Providers in Rural India

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ABSTRACT: India is considered to live in its villages, which is a true statement given that villages house 74.84 percent of the country's inhabitants (Census, 2020). However, a major chunk of the country's 5,75,000 communities lack a banking facility, leaving large swaths of the rural population financially disadvantaged. Because this segment's economic growth is so important to India's development, it's critical to integrate the un banked rural people into the official financial system. According to the RBI Annual Report 2020, there are 42,837 banking outlets in villages, which indicates that banking outlets, as well as additional channels such as Business Correspondents and Ultra-small branches, must cover over six lakh villages. In this research, we propose to investigate why formal financial service providers have not grown their footprint in remote areas despite the Central Bank's mission mode implementation of financial inclusion measures. This research is based on secondary sources such as published research articles, books, and Reserve Bank of India and Government of India reports.

INTRODUCTION

Organized financial services players, semi-formal organisations, and informal service providers make up India's rural financial services delivery model. Commercial banks, Regional Rural Banks, co-operative banks, primary agricultural co-operative societies, post offices, insurance company outlets, non-banking finance firms, and regulated microfinance institutions make up the organised financial system. Self-help groups, non-government organisations, and unregulated MFIs are examples of semi-formal institutions. Local landlords, moneylenders, local fertiliser or other input providers, as well as friends and relatives, are examples of informal providers.

The aim of India's poverty alleviation programme since independence has been to broaden the availability of official financial services to the rural population. Since 1951-52, the importance of banks as a source of rural family credit has steadily increased, according to the National Sample Survey Organization and the All India Debt and Investment Surveys. While there was a reduction in the share of banks in rural household debt between 1991-92 and 2002-03, it is projected that this dominant share will be restored over the next decade, given the RBI and Government of India's substantial policy initiatives for financial inclusion in partnership with NABARD.

The RBI's strategy for financial inclusion has been to connect people with traditional banking institutions. The goal of financial inclusion is better served by traditional banking institutions, as they are the only ones that can provide the full spectrum of products required to achieve real financial inclusion. The bank-led model, which relies on technology, was picked by the RBI for financial inclusion. Other middlemen and technological partners, such as mobile phone providers, have been allowed to collaborate with banks to provide services.

OBJECTIVES OF THE STUDY

1.To study and understanding of financial service providers' principles

2.To study and comprehend the limits that banks face.

3.To study and perceive the limits from the perspective of a rural customer

RESEARCH Methodology

The present study is based on the secondary data.

Constraints of banks

The following main causes can be attributed to banks' lack of progress in promoting financial inclusion in rural India:

The majority of commercial banks are now publicly traded. Stock markets are often focused on the short term. Banks' profit concerns may have deterred businesses that create a "visibility gap." Because of the high initial fixed expenses, the cost of delivering these services is more than the advantages received, at least in the short term. As a result, banks have a tendency to frown on financial inclusion or, at most, grudgingly accept it as a social or holding cost.'As a result, banks, like most formal for-profit institutions, are hesitant to invest a significant amount of time and resources in establishing a market due to the high initial set-up costs, particularly if they must meet the urgent needs of their shareholders. Large formal financial institutions have historically preferred to enter markets that have already been established and nurtured by smaller enterprises or informal sector players.

Small loan sizes, high transaction frequency, vast geographical spread, heterogeneity of borrowers, and widespread illiteracy all contribute to high transaction costs in rural lending in India. Due to the nature of financial inclusion, this balance sheet component (i.e., priority sector advances) is typically tiny in comparison to a bank's entire portfolio. Loan to a huge number of rural poor dispersed across large areas in a capital-starved country like India, where banks generally have a long list of borrowers, appears less efficient and costlier than credit to a few major borrowers in concentrated locations.

For banks, serving the rural poor is a high-risk, high-cost business . Providing financial services in rural areas is difficult due to the particular characteristics of agriculture and other rural economic activities, such as reliance on natural resources, long production cycles, and exposure to many risks. Because rural clients' income sources are sporadic and their spending patterns are volatile, bankers have reservations about their ability to repay loans. The lack of collateral by the borrower exacerbates the problem.

The rural poor spend a significant amount of money to build dwellings, frequently without titles, on government-allotted property, or even on encroached land. A persistent tendency exists for people to invest a significant portion of their income in house, land, and similar assets. The assumption of debt accounts for a large share of the investment in such housing and landed assets. It is also typical to pledge these assets in order to raise liquidity for unforeseen contingencies/health-related shocks or for consumption demands. Banks will not accept these property titles.Despite the existence of a liquid, active market for such assets among the impoverished themselves, banks typically refuse to consider these as mortgageable assets and refuse to support these investments. One of the reasons that the rural poor are forced to turn to other high-cost debt providers such as MFIs and informal lenders is banks' inability to accept these home assets as acceptable security.

Unless institutional frameworks become more effective, banks are finding that recovering delinquent loans portfolios in rural areas is a difficulty. Contract design, contract renegotiation, and contract enforcement remain inadequate due to the government's inability to build and enforce a legal and regulatory environment conducive to rural finance, making it even more difficult for lenders to offer borrowers with the necessary payback incentives. The populist programme of Agricultural Debt Waivers declared by the government at various periods in time has exacerbated the difficulty for banks.This has created a mindset among borrowers that believes that if they are consistent in their repayment history, they will not be eligible for waiver benefits at some point in the future. This has also resulted in a psychological phenomenon in which customers are not rewarded for having a solid payback history with banks, but instead are rewarded for not paying their debts.

“The formal banking industry has a striking lack of specialised expertise about the demands of the rural poor, and the informal providers' success has been largely due to their acquaintance with local communities.”

The RBI's credit planning policy, termed as the "Service Area Approach," limits competition in rural banking by assigning each rural branch a set of defined villages within which it can operate. Bank branches are unable to optimise branch infrastructure, and new non-service area bank branches, including private sector bank branches, are unable to enter the service area since this requires a "no-objection certificate" from the service area branch, which is often difficult to get. Furthermore, due to a lack of economies of scale on the part of banks, financial services may not be available if a region's economic base is limited.When banks are deciding whether or not to serve remote or sparsely inhabited areas, operational costs may be a factor to consider.

Another issue that banks encounter is bank employees' unwillingness to accept rural assignments. This resistance is frequently fueled by a lack of good schools, adequate health care, and a lack of social life in rural areas, as well as the official's distance from his or her home town. Security issues, such as insufficient safety of life and property (locations with inaccessible communication and dominance of extremist elements), may also influence the lack of branches, limiting bank development to remote areas.

Constraints of rural clients

The lack of required papers for creating an account with a formal institution is the first major limitation. Many rural residents lack either a legitimate identity document or evidence of address required to create a bank account, commonly referred to as "Know Your Customer" (KYC) paperwork. Even when documents are available, they are misplaced because there is no safe location to put them. Obtaining a duplicate document is a time-consuming process that requires the applicant to visit the relevant government office many times, wasting several working days.

When KYC documents are available, filling out the Account Opening Form becomes a huge challenge for rural clients. Although all bank branches should feature “May I Help You” counters to assist customers with transactions, in the majority of rural branches, this counter also houses a variety of other services. Another requirement for opening an account is the submission of three pictures as well as photocopies of KYC documents, which rural clients find difficult to meet. Higher loan processing times, along with bribery, could result in higher borrowers' effective costs and, as a result, credit rationing. The average time it takes for a loan to get authorised is 33 weeks by a commercial bank.

Another important constraint that the rural population faces is the lack of flexible products and services. Small rural borrowers, as previously stated, have irregular/volatile income sources and spending demands, and so choose to borrow frequently and return in small instalments. Although General Purpose Credit Cards and Kissan Credit Cards were introduced to satisfy this unmet demand among rural customers, their adoption has been slow, and many rural banks/branches do not offer products that match their clients' needs. Furthermore, while small rural borrowers seek savings and loan products, they also seek insurance, which banks typically do not provide.

Another important impediment to effective financial inclusion in rural India is transaction costs. The distance to the nearest financial institution contributes to the high transaction cost. The median distance to the nearest financial institution, according to the Rural Finance Access Survey of 2003, ranges from two kilometres (post office branches) to five kilometres (banks) (commercial banks, co-operative banks). Opening a bank account or applying for a loan is time-consuming and expensive. Obtaining a "No Dues Certificate" from each other lender in the service region stating that they do not have any outstanding loans is a time-consuming and inefficient exercise.

Another issue that makes rural borrowers less appealing to banks is that banks require collateral security, which poor rural borrowers lack. Indeed, the bulk of loans provided by commercial banks, RRBs, and co-operatives are secured, with 89 percent of RRB borrowers and 87 percent of commercial bank borrowers indicating that they were required to provide collateral. The most common type of collateral is land. Due to this reliance on collateral, the poor and vulnerable parts of the community, such as landless labourers, migratory communities, oral lessees, and women, are denied credit from formal financial institutions.In interacting with official financial institutions, poor customer service, extremely long wait times for financial transactions, and insufficient information about the financial services given are some of the additional irritants for rural clients.

CONCLUSION

Financial inclusivity is a major influencing factor, not just in India but around the world. Given banks' dominance, the Government of India and the Central Bank of India have embraced a bank-led paradigm for financial inclusion, in addition to leveraging non-bank financial companies' synergies.Banks have been encouraged to deploy Business Correspondents/Business Facilitators (BFs) to advance their financial inclusion efforts in remote rural areas, due to the resources and time constraints associated with creating a brick-and-mortar institution. RBI recently lifted some restrictions imposed in the past, including as the prohibition on using for-profit NBFCs and the requirement that the BC location be within 30 kilometres of the base branch. The government's launch of "The Pradhan Mantri Jan-Dhan Yojana" on August 28, 2014 was a crucial step in extending financial inclusion to every household.In this new environment, the introduction of innovative delivery channels such as microfinance institutions and non-bank financial companies (NBFCs) to collaborate with other large regulated financial institutions such as banks, insurance companies, pension funds, and asset management firms offers a lot of hope for a more financially integrated rural India. Furthermore, the Reserve Bank of India's licences for Small Finance Banks and Payments Banks are an important step toward deepening financial inclusion in the country, as they give customers a wide range of options for selecting the most appropriate delivery channel for financial services.

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