Is LAB the right formula for rural banking?

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No sooner did the chill from the global financial freeze start thawing, the Reserve Bank of India (RBI) got back to its business of developing financial markets and revisiting the regulatory framework. The overall thrust of the change programme in the past few months can possibly be divided into three broad categories: market development through creation of new markets and products, tightening and rationalising banking regulatory structures and a renewed impetus on financial inclusion. While developments in the first two sections are like 'work-in-progress', the sweeping changes contemplated for financial inclusion hold out the promise of altering the Indian banking landscape immutably.

Why is RBI pushing for financial inclusion now? There could be two strategic reasons. For the more cynically-minded, the campaign can be seen as a political instrument to further the current government's successful social schemes. But, from a wider business perspective, financial inclusion can be expected to not only provide ballast to the banking sector in times of future crises but also help the larger agenda of raising economic growth to the next level.

In the large number of circulars and working group reports issued by the central bank on financial inclusion, two stand out for their bold new approach. The first is expanding the list of eligible business correspondents who can provide banks with the so-called last-mile link to remote villages. These correspondents will be like agents and act as a bridge between the institution and the customer.

The second bit of far-reaching change suggested by the RBI is the freedom given to banks to open branches in tier 3 to tier 6 areas. These are typically areas with population less than 50,000 and scheduled commercial banks do not need RBI permission any longer to open branches in these centres. They have to only report to the central bank later. This is, by far, quite a radical move and could be a precursor to a future wave of further relaxations.
But will the new branch licensing bait work?

The Raghuram Rajan Committee on Financial Sector Reforms made interesting observations about the concept of inclusion followed so far. For one, the committee felt that the undue emphasis on credit delivery was misplaced and the focus should shift to improving access to financial services — such as insurance, payment services, inflation-indexed pension products and savings products — that help reduce vulnerabilities. Second, and more importantly, the committee also felt that the drive to reach out to unbanked millions through the existing physical structure was limiting in scope and was fraught with inherently-flawed cost matrices.

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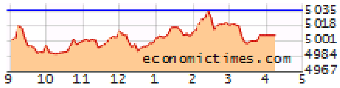

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