



A Study of Digital Financial Inclusion with Special Reference to Differential Banking in India

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Abstract

Indian Banking through a major change in the year of 2014, when following the recommendations of Nachiket More committee differential banking was adopted in the India banking system. This method of differential banking gave way to Payment Banks, Small Finance Banks and Universal Banking. The paper focuses on the study which implies the role of differential banking in the banking sector of India. The data for the study is gathered from the secondary data like journals, websites. The paper talks about the services, benefits, activities and the challenges faced by the differential banks. It is found that in various ways differential banking has the impact on the working of the traditional banks. Whereas Differential Banking is a key value proposition and would be really a game change in Indian Banking System.

Keywords: Small Finance Banks, Payment Banks, Traditional Banks, financial inclusion, differential banking.

Introduction

The financial sector should keep up with the necessities of the real sector in a dynamic, growth-oriented economy. The financial system must be adaptable and competitive in order to meet the varied demands and aims placed upon it by different elements of the economy. The financial sector matures as it has a variety of institutions that serve various market segments, from retail to wholesale, microfinance to project financing, nurturing specialized sectors, and providing specialized services and niche market products (Gandhi, R. (2015)). The Reserve Bank is aware of this issue, is committed to financial inclusion, and is investigating a number of options to promote the inclusion of the underserved and unserved population and areas, facilitate the provision of affordable financial services, and encourage innovative approaches (including channels, products, interfaces, etc.) among banks. Banks that have been differentiated from universal banks, such as commercial banks SBI, Canara Bank, ICICI, etc., have been inserted as specialist markets. Bankers target a particular market by determining the needs and wants of the clients.

Accordingly, they are designing their offerings. The distinction may be due to the amount of capital required, the range of activities, or the location of operations. As a result, they have a limited selection of services and goods to provide or operate under a distinct regulatory framework. Differentiated banks are not exactly a novel idea. In fact, because they serve specific localities, the Urban Cooperative Banks (UCBs), Primary Agricultural Credit Societies (PACS), Regional Rural Banks (RRBs), and Local Area Banks (LABs) could all be regarded as separate types of banks (Kamruddin, S & Sultana, A. , 2018).

Ramakrishnan, D (2014) The Indian banking system has been more resilient over time, and it has occasionally been able to weather challenging economic and financial circumstances. However, unlike several advanced and some emerging economies, the Indian banking system has struggled to achieve the necessary levels of banking penetration and inclusion. As a result, the banks' current organizational structure needs to be reoriented in order to improve its ability to support the economy. The idea of diversified banks in the nation was first proposed by the Nachiket Mor Committee for Financial Inclusion, which was established by the RBI. Specialized payment banks, retail banks, wholesale banks, infrastructure banks, etc. are among the ideas made by the panel. **Agarwal, R (2016)** stated that over the past 20 years, India's banking industry has undergone significant changes. In 1992, the changes were implemented, placing a greater emphasis on liberalization, competition, and the adoption of international norms and practices. Deregulation, upgrading prudential and risk management standards, consolidating, developing, integrating, and enacting payment and settlement systems, promoting financial inclusion, and developing financial markets were among the RBI's primary initiatives. The financial intermediaries have been encouraged to expand their reach into rural areas and successfully support the nation's consolidated economic growth.

Objectives:

1. To evaluate the role of Differential Banking in Indian banking sector.
2. To understand the aspect of differential banking and its role in the financial inclusion of the unbanked.

Literature Review

Literature review related to Differential Banking

Rajan (2009) Dr. Raghuram G. Rajan, Governor of the RBI, served as the chairman of a committee on financial sector reforms that looked at the value of small banks in India in 2009. The Committee had stated that there had been enough of a shift in the environment to justify experimenting with small bank licensing. It suggested lowering the permitted concentration requirements, requiring more capital, and strictly prohibiting related party transactions in order to mitigate the higher risk that comes with being regionally specialized by enabling more entrance to privately owned, well-run small finance banks (SFBs).

Jain, D. (2014) stated that it would be wise to keep using the current setup for the time being. Once a specific level of financial inclusion has been attained and the RBI is convinced with the reliability and durability of the risk

management systems across the board in the banking industry, the situation may be evaluated. Additionally, it might take into account reviewing applications more frequently before granting the unique licenses and achieving the ultimate goal of complete financial inclusion. But right now, there is a critical need for agreement to be reached on whether it should be adopted or not. The banking structure may possibly undergo a complete reorientation.

Ramakrishnan, D (2014) studied the Indian banking system has been more resilient over time, and it has occasionally been able to weather challenging economic and financial circumstances. However, unlike several advanced and some emerging economies, the Indian banking system has struggled to achieve the necessary levels of banking penetration and inclusion. As a result, the banks' current organizational structure needs to be reoriented in order to improve its ability to support the economy.

The Hindu (2014) analyzed the motivation to license specialty banks stems from the desire to expand financial inclusion in the nation. Payment Institutions and Small Banks are specialized or differentiating banks that share this goal.

Barua A, Kathuria Ret al., (2016) explored that India has a large opportunity to solve the market's inability to offer financial services to consumers with low incomes. Financial inclusion is now in the forefront of policy for the first time in the past ten years, and it has been expanded to cover savings, credit, and insurance, pensions and insurance. The ability to enhance delivery is becoming more and more possible thanks to technology; in particular, there are technologies that allow for improved targeting and the transfer of financial resources to families.

Literature review related to Payment Banks

Gupta, C (2016) analyzed that since the first player, Airtel, just launched its payments bank, the idea appears to be slowly but surely moving closer to reality. In Rajasthan, it launched its pilot program. More than 10,000 saving accounts were opened within two days of it going live, which helped the bulk of consumers who reside in semi-urban and rural areas. Other license holders are moving quickly to get ready for the opening of their ambitious payments banks, which would advance India's transition to a cashless economy and allegedly transform banking. The deadline is approaching because, in accordance with the regulations established by the RBI, the in-principle licensees would have 18 months beginning in August 2015 to build up fully operational payment banks with their unique business models.

Srinivas, G (2017) studied numerous alternative electronic media have emerged since the invention of computers and electronic communications. Payment methods have developed. Debit cards, credit cards, electronic funds transfers, direct debits, direct credits, online banking, and e-commerce payment systems are a few examples. Several payment methods include although that is effectively a new type of payment, credit methods. Payment systems, a key service offered by banks and other financial organizations, are utilized in place of tendering cash in domestic and international transactions.

Waghmare, (2016) explored banks and financial institutions make up the two segments that make up the Indian banking sector. Public, private, foreign, rural, urban, and rural cooperatives make up banks. While financial institutions include institutions at the federal, state, and other levels. With increased disposable income, the Indian banking sector is expanding at a good rate. With several government programs that support financial technology and greater use of unbanked and non-metropolitan regions, access to banking systems has also improved. Following demonetization, the Indian government is promoting cashless transactions, which has increased the use of internet banking, mobile banking, and payment banks. Compared to 2015, cashless payments rose by 22% in 2016.

Literature review related to Small Finance Banks

Jayadev, M., Singh, H et al., (2017) studied that with more firms competing in the market for rural financial services, the new small finance banks are set to reshape the banking industry in India. Building a portfolio of liability products, adhering to the legislative requirements for the cash reserve ratio, enhancing digital connectivity with a sizable rural customer base, and developing cost-effective banking solutions are the immediate challenges for these banks. To pave the way for distinctive banking, these new banks have not yet developed an innovative banking business model.

Khan, A (2018) analyzed that Small Finance Banks will contribute to a radical transformation of the Indian financial sector. It would aid in increasing banking's accessibility and competition for both borrowers and deposits, lowering the cost of banking for the average person. Additionally, the RBI permitted Small Finance Banks to create accounts entirely using digital signatures and electronic verification, eliminating the need for a wet signature and facilitating client on-boarding in remote locations where building a physical branch may not be practical.

Discussion

Small Finance Banks should take advantage of the opportunity that has been provided. However, a lot will depend on their business strategy, product offerings, and ability to reform and manage the banking industry profitably while overcoming numerous other hurdles. Based on past performance, any financial inclusion strategy in India can only be implemented through a commercially viable business endeavor.

According to Indian experience, local banks with geographical restrictions are crucial in providing finance to small businesses and farmers. The main issues for these banks have been risk management, capital requirements, exposure regulations, and governance, among other things. The sectoral oriented institution also plays a crucial role, and their performance depends on their capacity to manage funding and concentration risk (**CAFRAL, 2014**). The differentiated banking model will assist in achieving the goal of financial inclusion as well as favorable banking practices in light of these opportunities and challenges. Additionally, by leveraging their resources and experience, the payment bank and small bank authorized under this financial structure can emerge with a new dimension.

To increase usage, payment banks need to partner with some large financial institutions and offer deals, discounts, and other promotions. All of this will cause the financial sector to expand quickly and receive more funding. Regarding actual benefits, technology, safety, perception, and other issues, there are numerous obstacles and problems that need to be solved. Early adopters and the bulk of current users of this facility use it for its convenience, ease of transactions, and most crucially, cashless transactions. Users' concerns about security should be addressed by marketers as soon as they upgrade their systems. Payment banks, their importance, and their usability should be discussed by the government, banks, and marketers to boost subscriptions or users, which will encourage adoption of this system.

Differential Banking Contribution to Financial Inclusion.

Despite a number of actions done, including the nationalization of banks and the expansion of their rural network, as well as the creation of correspondent banks, regional rural banks, and self-help groups (SHGs), the government of India's goal of financial inclusion has largely remained unmet. Large-scale rural poverty continues to be a problem for independent India. People at the bottom of the pyramid require small credit facilities in addition to bank accounts in order to launch a business and sustain an ongoing source of income. Despite all the efforts made by many organizations to encourage financial inclusion, a sizable portion of the poor population continues to lack access to standard banking and payment facilities (Kishore, 2015). This urgent requirement has not been adequately met by the institutional structure.

The bank that stands out from the competition, for instance, will focus on collecting payments rather than extending credit. By increasing the number of players and services in the financial sector, the depth of the financial sector as well as the economy can be increased. Innovation in both the items and services to be provided and the front of participants can accomplish this. This mechanism is necessary and important for growth. For the authorities and participants, it will present a significant challenge in terms of monitoring and risk management.

Along with addressing the unbanked population who do not have access to the official financial industry, the differentiated banking model can open up a wide range of prospects.

Payment banks and small banks that can reach rural and semi-urban areas have recently received licenses from the RBI. India Post, which as of March 31, 2014, had 154882 offices and the largest postal network in the world, was granted a license by the relevant authorities to operate as a payment bank (www.indiapost.gov.in). In order to achieve this goal, "India Post" can use its extensive network to extend its reach to rural and unbanked areas.

Even though both local and international banks received the same banking license, having full access to payment and settlement systems allowed for the introduction of differentiated bank licensing, which would bring about a newer dimension (Jain, 2014).

Recommendations/ Conclusion

The establishment of Small Finance Banks represents a significant step towards financial inclusion and the achievement of the government's top priorities. These new specialized banks, along with the previously announced Payment Banks, constitute a solid approach to forward the financial inclusion objective despite many worries and difficulties. However, given the size of the nation, 10 of these institutions may not be sufficient and must be greatly expanded if financial inclusion is to receive a genuine and significant push on a national basis. With licensing and small banks operating under a differentiated banking model, the RBI's concerns about financial inclusion and the development of rural and underbanked populations could reach a new high. The banks using this strategy will be able to lessen the misuse of their funds and take advantage of new, differentiated prospects and untapped markets.

These banks can undoubtedly increase the level of financial literacy among rural populations and can effectively provide banking products and services to underserved market segments. These organizations may help clients in previously unreachable places with ease and convenience through the creative use of technology, turning the difficulties they face into possibilities. Even while they could have to compete with already-existing universal banks, they could still be a threat if they began to steal rural deposits and commitments from the priority sector.

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