Role of Capital Markets in Financial Inclusion

A business opportunity for all

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The economy has made rapid strides forward in the recent years along with higher savings and investment rates; however, inclusive growth continues to be a challenge. India not only lags behind the developed world but it also has a comparatively lesser degree of financial inclusion. Financial inclusion implies ease of access, convenience and low-cost availability of financial products and services to all members of an economy. It is absolutely necessary for achieving inclusive growth. Acknowledging the significance, the 11th plan not only aimed at rapid economic growth, but also greater inclusive growth.

The role of capital markets is vital for inclusive growth in wealth distribution and making capital available for corporates across the country. Capital markets can create greater financial inclusion by introducing new products and services tailored to suit investors' preference for risk and return as well as borrowers' project needs and risks appetite. Innovation, credit counseling, financial education and proper segment identification constitute the possible strategies to achieve this. A well developed capital market creates a sustainable national level low cost distribution mechanism for distributing multiple financial products and services.

Need for financial deepening

With long term growth trajectory, considerable financial deepening, increasing foreign cash-flows and increase in credit, deposits and bank assets as a percentage of GDP post 1990, rapid financial inclusion appears a reality if it can be co-ordinated by various financial institutions and with the application of technology. Lack of institutional co-ordination, competition, technology and financial literacy are causes of lower penetration of market. The capital markets also have problems of excessive concentration of trading at member level, company level and also geographically. The market also needs fair amount of development work on the bond market, interest rate futures, SME segment and in broadbasing the cash market.

Business opportunity

The capital markets in India need to cast off the conventional notion that financial inclusion is a part of social responsibility and should realize that it can actually foster profitable business. In Russia, the Russian Post earns 46% of its revenue from financial services through its post office network where post offices facilitate domestic and international money transfers for the people without a bank account.

Indian households are among highest savers in the world but less than 1% of the population participates in capital markets. Given a savings rate of 28% (2007-08) and the fact that more than 50% of household savings continue to be in relatively unproductive assets, prospects lie in driving these savings into the financial system and channelizing them into productive investments. In 2007-08, savings in physical assets accounted for 52% of household financial assets.

Mutual Funds Penetration

RBI has permitted banks to enter agreements with mutual funds for marketing and distributing mutual fund products and to offer discretionary portfolio management and investment advisory services.

The Indian mutual fund business may constitute only 1% of the global mutual fund sector, but has great potential. Mutual funds play an important role in mobilizing the household savings. Nearly 7.7 per cent of the country's total savings go into mutual funds. Fund houses have only 2,500 branches. Hence the existing banking network can be efficiently used for penetration of mutual funds which is limited mainly in top 10 cities and to only 3% of the households. Also, exchange network with over 200,000 terminals and investors in over 1500 towns can also contribute to growth of mutual funds through online distribution of mutual fund units.

Financial integration

100% financial inclusion would need financial literacy and matching technology to enhance accessibility besides adequate competition to cause more substantial marketing and selling. The business correspondent (BC) model can be replicated for increasing financial literacy and thereby increase direct participation of masses in the financial system. Financial inclusion also demands greater integration of network of banks, exchanges, insurance companies, fund houses and other financial bodies to facilitate and benefit from cross selling. Banks have a larger role to play in financial inclusion given 400 million account holders and 80,500 branches. Banks need to identify efficient delivery models from amongst the satellite branches, mobile branches, and mobile telephony services and BC model.

The economies of scale to the last mile are only possible if all financial services are aligned, bundled and integrated instead of developing silo of each vertical of insurance, banking, mutual funds, etc.

Technology

Mobile and internet are likely to trigger faster growth in Indian financial markets. Internet stock trading is popular among retailers. In India there are 70-80 million internet users and 5.2 million broadband internet connections. This signifies the great potential for internet trading. Interestingly, the penetration of mobile is more than internet in India, with over 400 million subscribers. In the near future a mobile trading revolution is likely to generate financial inclusion faster. The Unique Identification project will also help in providing access to a wider set and to those who are hitherto underprivileged.

Diversification and competition

Diversifying financial service providers and increasing the competition in the capital markets will foster innovation. Competition promotes efficiency and users receive better products at competitive prices. Competition in the currencies and commodities markets has led to significant developments in these markets. The average daily turnover in currencies has gone up to Rs. 14,881 crore in June 2010 from Rs. 887 crore in November 2008. Currently there are 100 banks, over 25 insurance and telecom companies competing to serve their best to a whopping 400 million customers. Competition has resulted in lowering telecom tariffs and enhance penetration in India. The mobile penetration has deepened with a growth rate of 71% and is expected to exceed 500 million by 2010. The following table illustrates the same:

Life Insurance Business			**Telecom Sector**			**Civil Aviation**		
Year	**2001**	**2009**	**Year**	**2002**	**2009**	**Year**	**2000**	**2010**
Companies	11	22	Service Providers	13	14	Domestic scheduled airline operators	5	15
Offices	2200	11800	**Year**	**2001**	**2009**			
Agents	0.1mn	~3mn	Subscribers	36 mn	500 mn	Domestic passengers	7.2 mn	44.5 mn
Sum Assured	$160 bn	$600 bn						

Conclusion

Capital markets can play a significant role in creating financial inclusion by making available multiple financial products and services to the masses. This requires conscious efforts to identify the respective target segments and enhance the penetration through financial education, product innovation, diversification, customization and simplification. India has sophisticated products and professionals with vast business potential; what is needed is greater financial integration and efforts by capital market players to assume new roles and responsibilities.

The views expressed by the author are personal and do not reflect those of the exchange