Cost of social banking

The traditional self-centered, profit-oriented commercial banking concept is fading, and a modern socio-economic role is emerging for the banks. The social control imposed over banks for the first time in 1967 has evolved into the philosophy of social banking.

Priority sector lending

Directed lending or priority sector lending (PSL) has long been used by developed as well as developing nations as an instrument of social banking to channel credit at preferential rates to strategic sectors of the economy, that have been marginalized by institutional credit.

Directed credit programs take various forms such as mandatory lending requirements, refinancing schemes, interest rate subsidies, credit guarantees, development financial institutions, etc., out of which, mandatory lending requirements are the most widely used.

In most countries, directed credit programs proved very costly, with the highest costs borne by the banking industry. Furthermore, in most of the countries, low repayment rates led to high NPAs that locked up bank assets, affecting the banks' profitability and efficiency.

Characteristics and impact of directed credit programs in various countries

Characteristic/impact area	Japan	Korea	China	Brazil	Thailand
Priority sectors	Export, large scale industry, small scale industry, agriculture	Export, heavy and chemical industries	Large state-owned enterprises	Rural areas, agriculture, infrastructure and housing finance	Exports, small scale industry, agriculture
Implementing institutions	Bank of Japan, government-owned financial institutions, commercial banks	Bank of Korea, government-owned financial institutions, commercial banks	Bank of China, policy banks	Public sector banks, commercial banks	Bank of Thailand, specialized government institutions
Main source of funds	Postal savings, commercial bank credit	Central bank credit, foreign debt capital	Central bank credit, foreign capital (mainly from Chinese diaspora)	Government credit, demand deposits of commercial banks	Commercial bank credit
Monitoring and supervision	High level	High level	Relatively little	Very little	Little
Costs and loan losses	Low costs because government absorbed loan losses	High loan losses	High loan losses	High loan losses	Inefficiency in banking sector because of interest rate ceilings
Impact	Beneficial for industrialization but costly to implement	High NPAs, costs borne by banks	High NPAs, high inflation	High NPAs, interest rates for non-priority sectors and inflation	Positive impact on access to finance in priority sectors only after deregulation

The available evidence on directed credit lending programs from various countries suggests positive social and economic outcomes from these programs. However, in certain cases, it raised concerns about the benefits from these programs not reaching the targeted sections and resulting in financial stress for the lenders.

Cost of priority sector lending

It is pertinent to look at the costs associated with the benefits of priority sector lending. The costs borne by the banking industry can be classified as direct and indirect costs.

Indirect costs

Non-performing assets (NPAs) are often referred to as the indirect costs. Money getting blocked in NPAs decreases the ability of the banks' lending, not only by the amount of NPAs, but also opportunity costs as that amount could have been invested in some return earning project or asset. NPAs do not only affect current profit, but also future streams of profit, which may lead to loss of some long-term beneficial opportunity.

Direct costs

Direct costs include funding, transaction and credit costs. Funding cost is the marginal or average cost at which banks are able to raise money from the depositors or market. Transaction cost is the cost of delivering credit to the borrower and includes wages, salaries, printing, rent, electricity, connectivity, transportation of cash, insurance, overhead, depreciation, etc. Credit cost is the sum of the risk cost (expected loss) and capital cost (unexpected loss) of providing a loan. Risk and capital losses arise from the probability of borrower default on loan repayment.

If there is a cross subsidization happening for the priority sector, the costs for it are currently being borne by either the depositors or the other borrowers and in the worst case, the shareholders of the banks. These costs are not being calculated currently.

Financial inclusion

Pradhan Mantri Jan Dhan Yojana (PMJDY) is a financial inclusion scheme launched by the government of India in August 2014 to ensure access to financial services in an affordable manner. It was dubbed as the world's biggest financial inclusion drive, with an entry in the Guinness Book of World Records to boast.

For public sector banks, which have become the channels of many welfare schemes, the PMJDY challenge has also brought some laurels. Out of the 31.11 crore beneficiaries as on 14 February 2018, the public sector banks have opened and now operate 25.12 crore accounts. Similarly, regional rural banks opened 5 crore accounts and private sector banks opened 99 lakh accounts.

The number of RuPay debit cards issued to the beneficiaries is 23.48 crore and a total amount of INR 74,650.57 crore has been deposited in these accounts.

According to data from the Finance Ministry, zero balance accounts under the scheme have come down since demonetization. In the first year of PMJDY, zero balance accounts made up for 77% of the total. In November 2016, 23% of the accounts had zero balance. Now, after 3 years of the launch, 20% of the accounts remain empty.

While the benefits have been immense, the scheme has also been a mammoth challenge for the banking system. It was a huge task in the initial years to educate people on the scheme and open accounts. Then came the Aadhaar seeding, followed by motivating people to use the RuPay debit cards issued to them. The banks had many tasks such as Aadhaar enrolment, bank linkage and account openings, along with the routine banking operations.

As on February 2015, banks had spent around INR 2000 crore for opening accounts under the scheme. For the banks, opening one account under the scheme costs around INR 140 as against the estimate of INR 80 per account. If we consider business correspondents, there are around 1.5 lakh BCs across the country. Even if you calculate INR 1000 per month, it will cost an amount. Then there are costs for connectivity, handheld devices, for which the bank has to pay. RuPay cards cost INR 20 each and there are costs for activation, PIN generation, posting, etc.

At the same time, banks are worried about the operating cost of PMJDY accounts. As per the data submitted by the government of India, many banks are not maintaining cost of operations of PMJDY accounts. However, in case of State Bank of India (SBI), maintenance of these accounts cost it INR 774.86 crore in the first 3 quarters of last year.

Way forward

The accounting professionals, the RBI and the bankers need to work together to determine the size of cost of social banking by evolving methods to determine or estimate that cost and disclose it in the financial statements.

Financial inclusion, along with the government's developmental programmes, is expected to result in overall financial and economic development in the country. As in the case of most developing countries, extending the banking services to unbanked groups is expected to be the key driver for inclusive growth.

Developing innovative delivery channels would be the key to the financial inclusion initiatives. There are several success stories globally where market players have worked out innovative models, often harnessing on technology, to overcome financial exclusion barriers. Mobile phone services, for instance, have been harnessed by several jurisdictions such as Kenya, through their M-PESA model, for providing access to financial services to people. Similarly, use of microfinance, banking agents, etc. by various jurisdictions has resulted in impressive gains from a financial inclusion perspective.

An efficient business model and delivery platform for provision of services by financial services providers is still evolving. Banks, in collaboration with other stakeholders and civil society, are working towards stabilizing and scaling up their models for social banking. A bank-led model which leverages technology to expand coverage and minimize cost of providing service can make social banking a viable and sustainable business for the banks.