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‘Financial Inclusion in India: Why Not Happened’

‘Financial Inclusion in India: Why Not Happened’

(A Project Report Submitted to Indian Institute of Banking & Finance under the Macro Research Award 2012-13)

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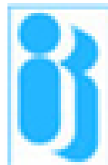

For
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CHAPTER I

INTRODUCTION, OBJECTIVES AND SCOPE OF THE STUDY

1.1 Introduction

Policies towards financial inclusion have received global attention including developed financial markets. Even in developed financial markets there are concerns about those excluded from the financial/formal banking system. In India, financial inclusion has been a national priority agenda for the Government of India over the last decade, especially beginning with the 11th plan efforts, to promote inclusive growth in the country. Efforts are being made by the authorities and the policy making institutions like the RBI, NABARD, Insurance Regulatory and Development Authority (IRDA), Pension Fund Regulatory and Development Authority (PFRDA) in terms of suitable regulations and guidelines for strengthening financial inclusion. But the debate in the public domain and anecdotal evidence seems to question the outcomes and impact of such inclusive policies. In light of this the present study limits its scope given the time of six months to take a relook at the overarching theme "Financial Inclusion: Why not happened". The theme is translated into an overarching and intriguing question, "Has financial inclusion happened in India?". To answer this question the study has followed the objectives set in the beginning with some revisions as suggested by the Research Advisory Committee of Macro research awards of IIBF.

1.2. Objectives

Accordingly the following objectives are formulated.

a) To conduct a critical review of the policies aimed at financial inclusion, study conflicts and overlaps in the policies and the instruments used to implement such policies.

b) To empirically assess the state of financial inclusion by constructing financial inclusion indices for thirty Indian states using data on self help group bank linkage programme and micro finance institutions.

c) To examine the supply side constraints in achieving the goal of financial inclusion.

1.3. Data and Method

The study is conducted mostly based on the secondary data available from the various sources at the national (RBI, NABARD, various committee reports, Ministry of Finance & MOSPI) and international level (World Bank, DFID, UNDP). Relevant data on different inclusion parameters are collected from the Handbook of Statistics on Indian Economy, 2013, annual reports of the National Bank for Agriculture and Rural Development, (NABARD) state of the sector reports on Microfinance, and the Bharat Microfinance report quick data 2012. An annual data set for major Indian states on the SHG Bank Linkage programme and Micro finance institutions are utilized for constructing a Financial Inclusion Index (FIIND) following Sarma(2012). Data on number of SHGs having savings accounts, number of SHGs with loan disbursements, SHG savings, SHG loans, number of MFIs and MFI loan outstanding are used for available number of years i.e. 2007-08 to 2009-10, and 2011-12.

1.4. Organization of the Report

The rest of the report is divided into four chapters. In chapter II, a critical review of the policy initiatives of Government, and other apex bodies and regulators such as: RBI, NABARD, PFRDA & IRDA are presented. In Chapter III, a financial inclusion index (FIIND) is being constructed on the basis of available secondary data for the period 2007-08 to 2011-12. To

address the supply side constraints, in Chapter IV, we have analyzed the supply side constraints based on the SHG-Bank linkage programme and the fluctuating non-performing assets (NPA) of the banks from the SHG portfolio. In this chapter, results of two case studies relating to mobile based money remittances and preference of individuals for informal sources of borrowing are also presented to understand the supply side issues towards financial inclusion.

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CHAPTER II
FINANCIAL INCLUSION IN INDIA:
A CRITICAL REVIEW OF POLICY INITIATIVES & OUTCOMES

2.1 Introduction

In this chapter an attempt is made to review the spectrum of policy initiatives aimed at financial inclusion and their outcomes. The review covers: (i) conceptual framework of financial inclusion, (ii) extent of financial inclusion in India and a comparison with the global scenario, (iii) approaches to financial inclusion - some international/national initiatives, (iv) initiatives taken by Government and other regulators for inclusion, and (v) outcomes on the process of inclusion.

2.2 Importance of Financial Inclusion

Poverty and exclusion continue to dominate socio-economic and political discourse in India as they have done over the last six decades in the post-independence period. Poverty reduction has been an important goal of development policy since the inception of planning in India. Various anti-poverty, employment generation and basic services programmes have been in operation for decades in India. The on-going reforms also attach a great importance to removal of poverty and to addressing the wide variations across states and the rural-urban divide. Though the Indian economy recorded impressive growth of 8.0% (average) in the last decade but its impact has sadly not fully percolated to the lowest deciles. Despite being one of the ten fastest growing economies of the world, India is still home to one-third of the world's poor. So, in this context, Financial Inclusion can help the society and the economy.

Financial Inclusion has the ability to generate positive externalities: it leads to increase in savings, investment and thereby, spurs the processes of economic growth. It also provides a platform for inculcating the habit of saving money, especially amongst the lower income category that has been living under the constant shadow of financial duress, mainly because of absence of savings, which makes them a vulnerable lot. Increase in the saving habits of the households, enhance agricultural productivity by the way of formal credit and increase the living standard of the people, which will promote inclusive growth in the country. This formal financial network could unleash their creative capacities besides augmenting domestic demand on a sustainable basis driven by income and consumption growth from such sectors.

These efforts do have multiplier effect on the economy as a whole through higher savings pooled from the vast segment of the bottom of the pyramid (BoP) population by providing access to formal savings arrangement resulting in expansion in credit and investment by banks. Deeper engagements of the BoP/under-banked population in the economy through the formal financial system could lead to improvement of their financial conditions and living standards, enabling them to create financial assets, generate income and build resilience in terms of financial risk protection to meet macro-economic and livelihood shocks. Government also immensely benefits by way of efficient and leakage-proof transfer of vast amounts of welfare benefits to the targeted, disadvantaged groups of population.

As we all know, Financial Inclusion has now been viewed as a remedy to plug gaps and leaks in distribution of government benefits and subsidies through direct benefit transfers (DBT) to beneficiaries' bank accounts rather than through subsidizing products and making cash payments. Thus, on the whole, Financial Inclusion has the potential to bring in the unbanked

masses into the formal banking system, channelize their savings, stoke their entrepreneurial ambitions by making available credit and thus give a fillip to the economy.

2.3 Conceptual Framework of Financial Inclusion

In advanced economies, Financial Inclusion is more about the knowledge of fair and transparent financial products and a focus on financial literacy. However, in emerging economies, it is a question of both access to financial products and knowledge about their fairness and transparency. In the following paragraphs we will see the difference and missing elements in different financial inclusion definitions defined by various regulators and global institutions.

Before going in to the depth and breadth of financial inclusion, there is a need to review the definitions to measure financial inclusion in India and abroad. Fee important definitions given by the RBI and certain celebrated committees are presented below.

i) C. Rangarajan Committee: Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost

ii) RBI's definition: Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players.

iii) Raghuram Rajan Committee: Financial inclusion, broadly defined, refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products.

iv) CGAP: Financial Inclusion may be defined as the process of ensuring access to financial services and adequate credit when needed by vulnerable group such as weaker section and low income group at an affordable cost

v) G20: Financial Inclusion refers to a state in which all working age adults have effective access to credit, savings, payment, and insurance from formal service providers. “Effective access” involves convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than existing informal options

The above definitions mainly focused on: i) Access to an array of financial products and services - credit, savings, insurance, payments, and remittances by all sections of society in general and low income segments in particular, ii) provided by formal institutions and iv) in an affordable, convenient and transparent manner. Though the definitions prima facie seem to have an access/input focus, the outcomes can be judged from both supply and demand side factors. For example the convenience and flexibility in availing of financial services by the underprivileged relate to demand side issues and the ease of implementation of the inclusive policies by the formal financial institutions relate to the supply side factors. The supply side factors often are interfered with the service seeking behavior of the underprivileged/ vulnerable.

2.4 Financial inclusion - International Experiences

The importance of an inclusive financial system is widely recognized in the policy circles, not only in India, but has become a policy priority in many countries. Several countries across the globe now look at financial inclusion as the means of a more comprehensive growth, wherein

each citizen of the country is able to use their earning as a financial resource that they can put to work to improve their future financial status, adding to the nation's progress.

In advanced markets, it is mostly a demand side issue. Initiatives for financial inclusion have come from the financial regulators, the governments and the banking industry. The banking sector has taken a lead role in promoting financial inclusion. Legislative measures have been initiated in some countries. For example, in the United States, the Community Reinvestment Act (1997) requires banks to offer credit throughout their entire area of operation and prohibits them from targeting only the rich neighborhood. In France, the law on exclusion (1998) emphasizes an individual's right to have a bank account. The German Bankers' Association introduced a voluntary code in 1996 providing for an "everyman" current banking account that facilitates basic banking transactions. In South Africa, a low cost bank account called "Mzansi" was launched for financially excluded people in 2004 by the South African Banking Association. In the United Kingdom, a "Financial Inclusion Task Force" was constituted by the government in 2005 in order to monitor the development of financial inclusion. The "Principles for Innovative Financial Inclusion" serve as a guide for policy and regulatory approaches with the objectives of fostering safe and sound adoption of innovative, adequate, low-cost financial delivery models, helping provide conditions for fair competition and a framework of incentives for the various banks, insurance, and non-bank actors involved and delivery of the full range of affordable and quality financial services. The extent of financial exclusion in India is found to be higher as compared with many developed and some of the major emerging economies. The wide extent of financial exclusion in India is visible in the form of high population per bank branch and low proportion of the population having access to basic financial services like savings accounts, credit facilities, credit and debit cards.

Financial Inclusion Initiatives in Different Countries		
Country	Legislation instrument / Policy Scheme	Objectives
United Kingdom	Social Exclusion Unit (SEU), 1997	▪ To reduce social exclusion of which financial inclusion is an integral part.
	Policy Action Teams (PATs)	▪ To look in an integrated way at the problems of poor Neighbourhoods.
	Financial Inclusion Task Force	▪ Access to banking, access to affordable credit. ▪ Access to face-to-face money advice.
	Financial Inclusion Fund	▪ Access to banking services. ▪ Access to affordable credit. ▪ Access to money advice.
USA	The Community Reinvestment Act, 1977	▪ Prohibits discrimination by banks against low and moderate income neighbourhoods. ▪ To make mortgage loans to lower-income households. ▪ Banks are rated every three years on their efforts in meeting community credit needs.
	Matched Savings Scheme (MSS) 1997	▪ Prohibits discrimination by banks against low and moderate income neighbourhoods. ▪ Matching money has to be spent on one of a range of ▪ Prescribed uses such as education, business or home purchase.
France	Banking Act, 1984	▪ Any person with French nationality has the right to open an account with any bank. ▪ If refused the aggrieved person can apply to the Banque de France to designate a bank that should open an account.
	French Banker's Association (Basic Banking Service Charter of 1992)	▪ Committed to providing; Affordable account, Cash Card, Free access to a cash machine, Distance payment facilities, Bank Statement and Negotiable number of cheques.
Australia	Australian Bankers Association (ABA) Code of Practice, 1995	▪ Generic Account was introduced in 2002. ▪ Staff to give information about suitable accounts to low income Customers. ▪ Face-to-face banking services even after branch closure through alternative means such as franchising. ▪ Three months written notice to customers before closing any Branch.

	Rural Transformation Centre Programme (RTCP)	▪ To provide banking and other transaction services to communities without banking facilities. ▪ Using existing stores and post offices or stand-alone centres. ▪ Install Electric Point of Sale (EPOS) equipment in post offices.
Belgium	Charter of Basic Banking Services, 1996	▪ Provide a basic bank account with no minimum balance and without overdraft facilities. ▪ Credit transfers, direct debits, and deposit and withdrawal Facilities. ▪ If refused, customer must be informed the reasons, i.e., laundering, bad credit history, etc.
	Basic Banking Act, 2003	▪ Sanctions if principles of Charter on Basic Banking Services, 1996 are not applied.
Canada	Access to Basic Banking Services Regulations, 2003	▪ Personal bank accounts to all Canadians regardless of employment or credit history and with minimum identification requirements. ▪ Banks/FIs to encash government cheques at no charge.

Source: World Bank (2009)

Table 2.1: Financial Inclusion: Cross Country Comparison				
Country	Number of Branches	Number of ATMs	Bank credit	Bank deposits
	(per 0.1 million adults)		(as per cent of GDP)	
India	10.64	8.90	51.75	68.43
Austria	29.61	166.92	128.75	107.10
Brazil	46.15	119.63	40.28	53.26
France	41.58	109.8	42.85	34.77
Mexico	14.86	45.77	18.81	22.65
United States	35.43	…	46.83	57.78
Korea	18.80	…	90.65	80.82
Philippines	8.07	17.70	21.39	41.93
Afghanistan	2.25	0.5	11.95	21.4
Source: World Bank, Financial Access Survey				

These statistics, staggering as they are, do not convey the true extent of financial exclusion. Even where bank accounts are claimed to have been opened, verification has shown that these accounts are dormant. Few conduct any banking transactions and even fewer receive any credit. Millions of people across the country are thereby denied the opportunity to harness their earning capacity and entrepreneurial talent, and are subjected to marginalization and poverty.

2.5 Extent of Financial Exclusion in India

In India, we don't have any single measure of inclusion as of today. However, a number of committees, some institutions and some individual researchers have estimated the inclusion level in different ways including some indices. Though, the recommendations of these committees are not unified but they throw some light on financial inclusion in India. In the following, we will broadly summarize some of the findings such as:

The ***Rangarajan Committee (2008)*** had estimated that around 41% of the population in the country are unbanked, 61% in rural areas and 40% in urban areas. Out of the 6 lakh villages in the country, only about 10% have a commercial bank branch. The proportion of people having any kind of life insurance cover was is as low as 10% and proportion having non-life insurance is an abysmally low 0.6%. People having debit cards comprise only 13% and those having credit cards only 2%.

NSSO data reveal that 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not have access to credit, either from institutional or non-institutional sources. Further, despite the vast network of bank branches, only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). Farm households not accessing credit from formal sources as a proportion of total farm households is

especially high at 95.91%, 81.26% and 77.59% in the North Eastern, Eastern and Central Regions respectively. Thus, apart from the fact that exclusion in general is large, it also varies widely across regions, social groups and asset holdings. The poorer the group, the greater is the exclusion.

According to the ***financial inclusion survey (2003),*** there are a large number of households (145 million) excluded from banking system and around 50% of the population do not have bank account. Only 34% of the population are engaged in formal banking. Out of the 6 lakh villages only, 30,000 villages have commercial bank branch. Insurance penetration is also at a low level as 10% have life insurance cover and just 9.6% have any non-life insurance.

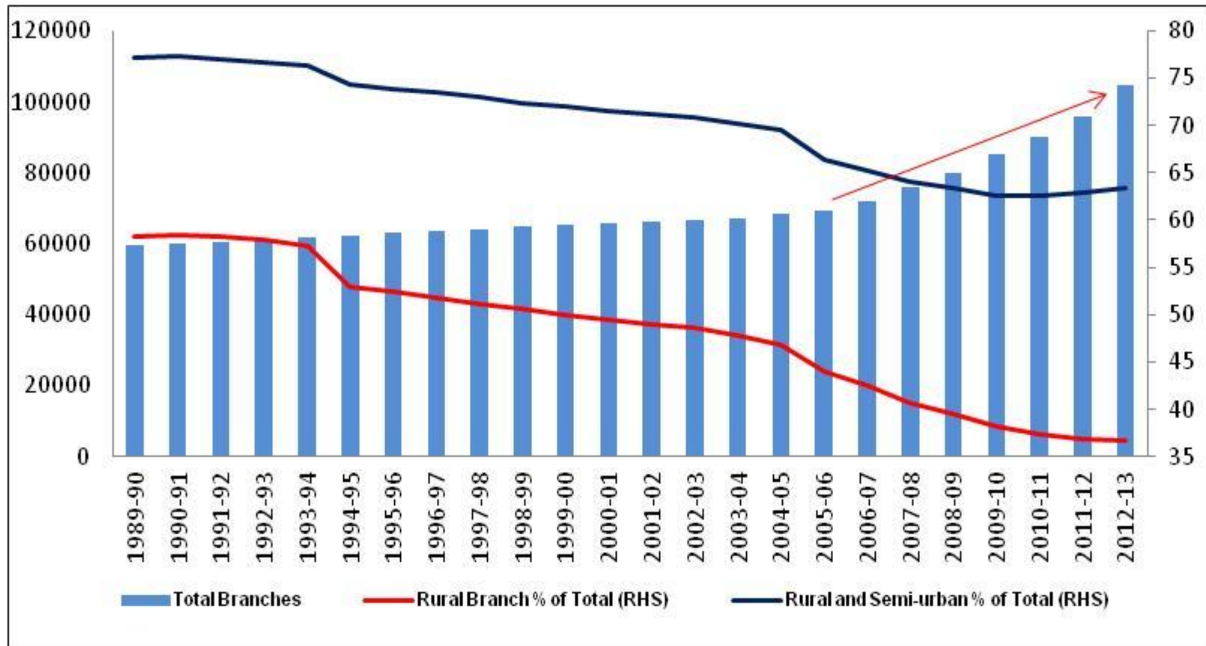
The recent census of India (2011) stated that financial inclusion in a country like ours with large population and geographical spread is, indeed, challenging. The data released indicates that only 58.7% of households in India avail of banking services with the figure being 54.4% for rural areas and 67.8% for urban areas.

The extent of financial exclusion in India is found to be higher as compared with many developed and some of the major emerging economies. The wide extent of financial exclusion in India is visible in the form of high population per bank branch and low proportion of the population having access to basic financial services like savings accounts, credit facilities, credit and debit cards. In the following table, the widely quoted indicators of financial inclusion are presented to see the time-series progress of inclusion in the country over time.

Table 2.2: Indicators Financial Inclusion								
	1969	**1980**	**1991**	**2000**	**2010**	**2011**	**2012**	**2013**
No of Commercial Banks	89	154	272	298	169	169	173	157
No of Bank Offices (include admin offices)	8262	34594	60570	67868	88203	94019	101261	104647
of which Rural & Semi-Urban bank offices	5172	23227	46550	47693	53551	57167	62061	66273
Number of Branches	8,262	32419	60,220	65412	88441	93799	99,884	-
Number of ATMs	-	-	-	-	60,153	74,505	95,686	-
Population per Branch	63800	19137	14054	15515	14,000	13,466	12,921	12,000
Population per ATM	-	-	-	-	19,700	16,243	11,236	-
People having Deposit Accounts (%)	-	-	-	-	55.80	61.20	74.6	-
People having Credit Accounts (%)	-	-	-	-	9.30	9.90	10.8	-
People having Credit Cards (%)	-	-	-	-	1.53	1.49	1.5	-
People having Debit Cards (%)	-	-	-	-	15.20	18.80	22.9	-
Credit-GDP Ratio (%)	8.6	17.6	20.4	22.3	50.2	51.4	52.1	52.4
Credit-Deposit (%)	78.3	67.8	60.4	53.6	72.2	75.7	78.0	78.1
Deposits (% of National Income)	16	36	48	54	69	67	66	67
Per capita Deposits (Rs.)	88	738	2368	8542	38062	43034	48732	55780
Per capita Credit (Rs.)	68	457	1434	4555	27489	32574	38033	43468
Priority Sector Advances (%)	15	37	39	35	35.6	34.5	32.9	31.6
Branches per 1000 Square km	--	--	--	21.9	25.49	26	30.4	-
Insurance Coverage (%)	--	0.8	0.9	2.3	5.2	5.1	4.1	-
Pension Coverage (%)	--					12	13	-
Source: Reserve Bank of India								

In the last ten years, due to different financial inclusion drive by banks and opening of branches in large number of unbanked places, the population per bank branch improved from 14,000 in 2009-10 to 12,000 in 2012-13, while population per ATM from 19,700 to 11,003 during the same period, showing significant improvement in access to banking services. However, banking has still not reached a large section of the population despite a strong and wide branch network of 1,00,000 plus bank branches spread across the length and breadth of the country.

Chart 1: Branch Network: Population Group-Wise



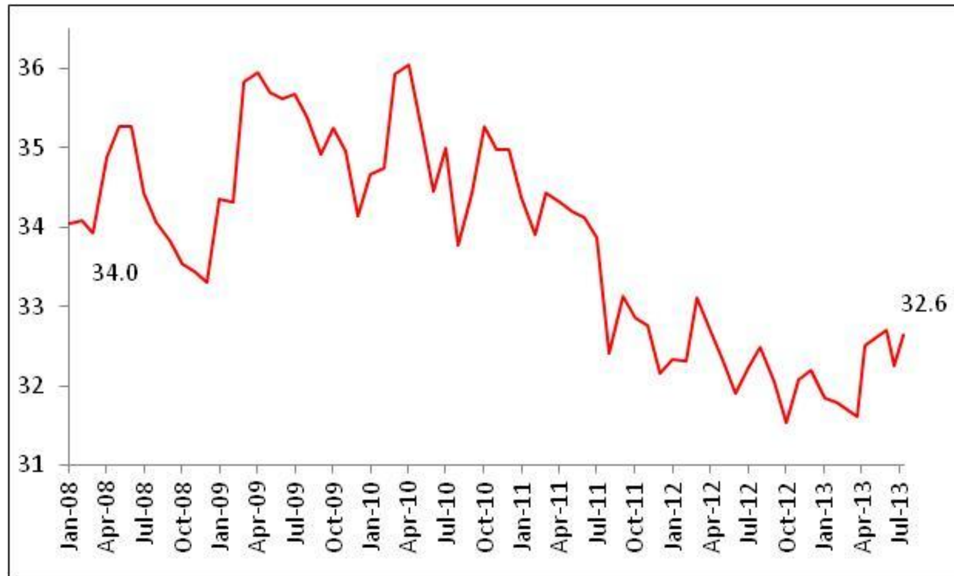
Source: RBI

2.5.1 Priority Sector Lending

The priority sector comprises a vast section of the population in sectors such as agriculture, micro and small enterprises (MSEs), education and housing. RBI has mandated a target for priority sector advances at 40% of the Adjusted Net Bank Credit (ANBC) or credit equivalent of off-balance sheet exposure (OBE), whichever is higher. But, if you will go by figure, banks are not able to achieve the set target over the years. There are a number of reasons, may be due to higher risk of deteriorating asset quality, higher cost of deploying funds.

As on March 31, 2013 domestic banks (both public and private) were below the target of priority sector lending. During this period, 16 of the 26 public sector banks, 10 of the 20 private sector banks and 2 of the 41 foreign banks could not achieve the target of overall priority sector lending.

Chart 2: Share of Priority (% NF Credit)



Source: RBI Data Base

2.5.2 Flow of credit to the Agriculture Sector

Over the years, the share of agricultural credit in total non-food credit is declining. In 1989-90, it was 20.9% but afterwards declined to 12.1% in March 2013. The following chart depicts the share of agricultural credit (both direct & indirect) in total non-food credit over the years.

Chart 3: Share of Agri.-Credit (% NF Credit)

Source: RBI Data Base

A target of Rs. 5,750 billion for agriculture credit during the year 2012-13 was fixed by the Government. Against this target, banks, including co-operative banks and RRBs, disbursed Rs 6,073.75 billion, which formed 105.6% of the target as at the end of March 2013.

2.6 Importance of Financial literacy and Financial Education

There are a number of reasons for exclusion. In remote, hilly and sparsely populated areas with poor infrastructure, physical access hinders inclusion efforts. From the demand side, lack of awareness, low incomes/assets, social exclusion, and illiteracy mainly stand as barriers. Among the supply side factors distance from branch, branch timings, complicated documentation and procedures, unsuitable products, language, staff attitudes are common reasons for exclusion. All these result in higher transaction cost apart from procedural hassles. On the other hand, the ease of availability of informal credit sources drive people away from formal institutions. The requirements of independent documentary proof of identity and address can be a very important barrier in having a bank account especially for migrants and slum dwellers.

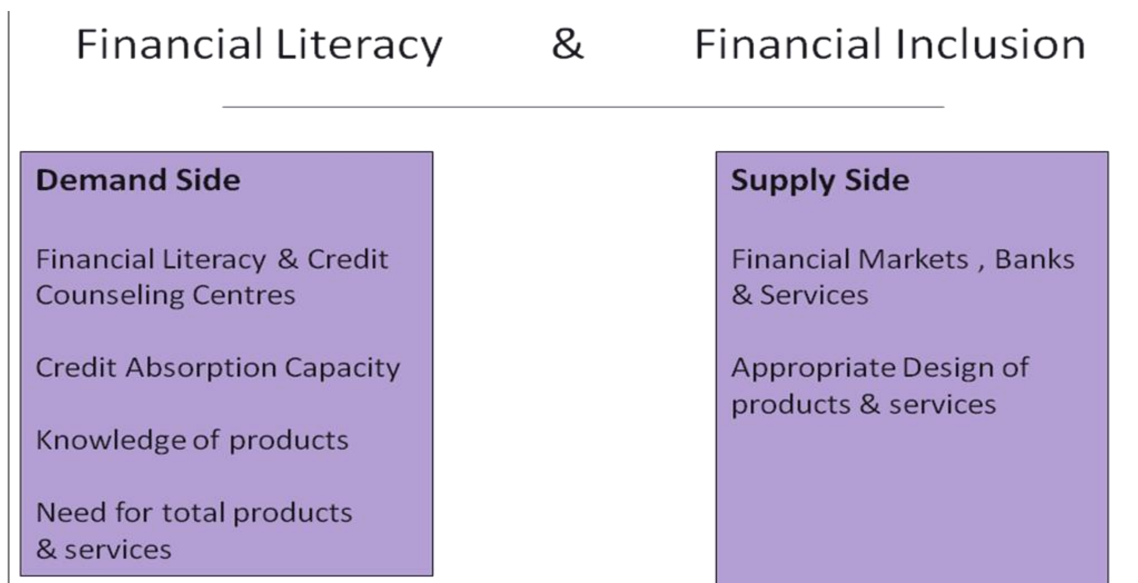
Problem of Access to Formal Institutions

- Distance continues to be a major issue, though BCs have started to provide succor in certain regions.
- Navigating the Procedures remains a challenge;
- Lack of knowledge (institutional as well as user level);
- Insufficient infrastructure leading to long hours of waiting, if banks are accessible;
- Lack of customized products and services. In contrast informal and quasi-legal entities win on this count.
- Human resources of formal financial institutions unequipped to deal with challenges of FI.

There are may be a number of solutions to this problem but literacy and awareness is vital one among the all. Financial Inclusion and Financial Literacy are twin pillars: i) Financial Literacy stimulates more of the demand side , making people aware of what they can demand and ii) financial Inclusion acts more from supply side providing the required financial market/services

Issues in Financial Literacy in India

- A large population of alphabetically illiterate population - requiring basic financial knowledge
- A large section of financially excluded population- need to be told of benefits of financial inclusion and also to be provided
- A large growing segment of educated middle class-requiring financial education
- A growing capital market with increasing retail participation-requiring financial education and consumer protection
- A growing insurance market with participation of private players - need consumer protection and financial education
- A large section of workers having no pension
- A move from Defined Benefit Pension Schemes to Defined Contribution Pension Schemes
- Hence, a large workforce need to be told about riskiness of various investment portfolios



OECD defines Financial Literacy as a combination of financial awareness, knowledge, skills, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial well being. Financial literacy can be achieved through a process of financial education. Financial education is defined by OECD as "the process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being".

The Reserve Bank of India defines financial literacy or financial education as "providing familiarity with and understanding of financial market products, especially rewards and risks, in order to make informed choices. Viewed from this standpoint, financial education primarily relates to personal finance to enable individuals to take effective action to improve overall well-being and avoid distress in matters that are financial". To increase the literacy and awareness level, the RBI and the Government have taken a number of initiatives and the effects may materialize in the long run. Some of the initiatives are as the following:

- RBI has undertaken a project titled 'Project Financial Literacy' with the objective of disseminating information regarding the central bank and general banking concepts to various target groups including school and college going children, women, rural and urban poor, defence personnel and senior citizens.
- A multilingual website in 13 Indian languages on all matters concerning banking and the common person has been launched by RBI. Illustrated books have been prepared for the different target groups and are widely distributed in regional languages.

- Financial literacy programmes are being launched in each State with the active involvement of the State Government and the State Level Bankers Committees. These programmes include skits, road shows, exhibitions, workshops, seminars, and dissemination through radio and television.
- Financial education stresses on capacity building measures to enable small and marginal borrowers to avail of the entire suite of financial products and services i.e., savings, remittance, insurance and pension from the banking sector, in addition to credit. In view of the utility of these centers banks have been asked to set up Financial Literacy and Credit Counseling Centers (FLCCs) in all districts. So far, over 658 FLCCs have been set up in various States in the country.
- There are other specific initiatives by numerous financial service providers in the micro segment. The State level rural livelihood missions have prepared modules on financial literacy in vernacular languages. For example the Sanchayan society Delhi is working on a complete financial literacy programme where financial literacy is defined as "the ability to understand finance and financial services. Financial literacy is a life-long process of learning and knowledge enhancement". The society works on literacy relating to saving, credit, remittance, pension, and personal financial management.

2.7 Process of Financial Inclusion in India

The origins of the present financial inclusion can be traced to the United Nations initiatives, which broadly described the main goals of inclusive finance as access to a range of financial services including savings, credit, insurance, remittance and other banking / payment services to all 'bankable' households and enterprises at a reasonable cost. The Report of the Centre for

Global Development (CGD) Task Force on Access to Financial Services (October, 2009) has laid down the broad policy principles for expanding financial access, including institutional mechanisms, with particular emphasis on the need for ensuring data collection, monitoring and evaluation. The G20 Toronto Summit (June, 2010) had outlined the "Principles for Innovative Financial Inclusion", which serves as a guide for policy and regulatory approaches aimed at fostering safe and sound adoption of innovative, adequate, low-cost financial delivery models, helping provide conditions for fair competition and a framework of incentives for the various bank, insurance, and non-bank actors involved in the delivery of a full range of affordable and quality financial services.

In India also, financial inclusion has been a national priority agenda for the Government of India over the last decade. The Committee on Financial Inclusion headed by Dr C Rangrajan (2008) has observed that financial inclusion must be taken up in a mission mode and suggested a National Mission on Financial Inclusion (NMFI) comprising representation of all stakeholders for suggesting the overall policy changes required, and supporting stakeholders in the domain of public, private and NGO sectors in undertaking promotional initiatives. The eleventh Five Year Plan (2007-12) envisioned inclusive growth as a key objective. Achieving inclusive growth in India is the biggest challenge as it is very difficult to bring 600 million people living in rural India into the mainstream.

Efforts are being made by the authorities and the policy making institutions like Government of India, RBI, IRDA (micro-insurance), PFRDA (for micro-pensions), have developed regulations and guidelines for strengthening financial inclusion but these are yet to have a substantial impact on outreach to the excluded population. Measuring insurance, remittances and pension inclusions as part financial inclusion still remains as an issue to be attempted and resolved. It appears that

while some effort has been made to develop a facilitating regulatory framework, it has not yet gone far enough to overcome the substantial cost implications of an outreach to large number of people, often in dispersed locations, with small value accounts. As a result, the institutions responsible for providing financial services do not yet perceive the financial inclusion business as really sustainable.

In India, we have adopted a bank-led model for financial inclusion, but have permitted non-bank entities to partner banks in their FI initiatives.

2.8 Financial Inclusion: National Initiatives

The history of financial inclusion in India is actually much older than the formal adoption of the objective as outlined above. The RBI and government play an important role in promoting financial inclusion for economic growth to increase the banking penetration in the country. Before the 1990s several initiatives were undertaken which included creation of State Bank of India in 1955; nationalization of commercial banks in 1969 and 1980. Initiating the Lead Bank Scheme in 1970 was a big step to expand financial inclusion. Among other steps one finds priority sector lending norms, branch licensing norms with focus on rural and semi urban branches. The National Bank for Agriculture and Rural Development (NABARD) was set up in 1982 mainly to provide refinance to the banks extending credit to agriculture. Establishment of regional rural banks (RRBs) in 1975 was also one of the major steps for encouraging branch expansion in rural areas.

Incorporation of Regional Rural banks (RRBs), Service Area Approach and formation of Self-Help Groups - all these were major initiatives taken by the Government of India that aimed at taking banking services to the masses. The nexus between economic growth, financial deepening

and financial inclusion has been well recognized in India's development strategy, particularly since the reforms from the early 1990's, when the financial and economic reforms processes were initiated.

However, a more focused and structured approach towards financial inclusion has been, in effect, followed since the year 2005, when the RBI decided to implement policies to promote financial inclusion and urged the banking system to focus on this goal. The 11th Five Year Plan (2007-12) of the Government of India has further emphasized the initiatives on financial inclusion with its greater focus in 'inclusive growth'. Recent policy initiatives to drive financial inclusion, including formulation of a board approved Financial Inclusion Policy (FIP) by the banks thereby attempting to strike a balance between the requirements of financial inclusion and that of soundness of financial institutions and stability of the financial system (RBI, 2012). These initiatives have paid off in terms of a network of branches across the country. The brick and mortar infrastructure expanded; the number of bank branches multiplied ten-fold – from 8,000+ in 1969, when the first set of banks were nationalized, to 100,000+ today. Despite this wide network of bank branches spread across the length and breadth of the country, banking has still not reached a large section of the population.

2.8.1 RBI's Policy Initiatives to foster Financial Inclusion

In India, RBI has initiated several measures to achieve greater financial inclusions, such as facilitating no-frills accounts and General Credit Cards (GCC) for small deposits and credit. Some of the supporting policy initiatives are:

I) REACH

a) **Branch Expansion in Rural Areas:** Branch authorization has been relaxed to the extent that banks do not require prior permission to open branches in centres with population less than 1 lakh, which is subject to reporting. To further step up the opening of branches in rural areas, banks have been mandated to open at least 25% of their new branches in unbanked rural centres. Of the total 6,317 new branches opened during 2012-13, almost 65% were located in rural and semi-urban areas. Banking connectivity has been extended to 268,454 villages up to March 2013 from 67,694 villages in March 2010. A total of 7407 rural branches have been opened during the period 2010 to 2013.

   In the Annual Policy Statement for 2013-14, banks have been advised to consider frontloading (prioritizing) the opening of branches in unbanked rural centres over a three year cycle co-terminus with their FIPs. This is expected to facilitate the branch expansion in unbanked rural centres.

b) **Agent Banking - Business Correspondent/ Business Facilitator Model:** In January 2006, the Reserve Bank permitted banks to utilize the services of intermediaries in providing banking services through the use of business facilitators and business correspondents. The BC model allows banks to do 'cash in - cash out' transactions at a location much closer to the rural population, thus addressing the last mile problem.

   - In January, 2006, RBI permitted banks to engage business facilitators (BFs) and BCs as intermediaries for providing financial and banking services. The BC model allows banks to provide doorstep delivery of services, especially cash in-cash out transactions, thus addressing the last-mile problem.

- To ensure increased banking penetration and control over operations of BCs, banks have been advised to establish low cost branches in the form of intermediate brick and mortar structures in rural centres between the present base branch and BC locations, so as to provide support to a cluster of BCs (about 8-10 BCs) at a reasonable distance of about 3-4 kilometers.

II) ACCESS

a) **Relaxed KYC norms:** KYC requirements for opening bank accounts were relaxed for small accounts in August, 2005; and thereby simplifying procedures by stipulating that introduction by an account holder who has been subjected to the full KYC drill would suffice for opening such accounts.

RBI has allowed 'Aadhaar' to be used as one of the eligible documents for meeting the KYC requirement for opening a bank account.

b) **Roadmap for Banking Services in Unbanked Villages**

- In 1st phase, banks were advised to draw up a roadmap for providing banking services in every village having a population of over 2,000 by March 2010. Banks have successfully met this target (74,144 villages) and have covered 74398 unbanked villages. (99.7% achievement)
- In 2nd phase, Roadmap has been prepared for covering remaining unbanked villages i.e. with population less than 2000 in a time bound manner. About 4,90,000 unbanked villages with less than 2000 population across the country have been identified and allotted to various banks. The idea behind allocating villages to banks was to ensure availability of at least one banking outlet in each village.

- Further, Dr. Raghuram Rajan, Governor, RBI gave more stress on financial inclusion on his statement on 04 September 2013. He asked Dr Nachiket Mor to head a committee on financial inclusion, to review the approach and suggest the way forward to the development mission of the RBI.

III. PRODUCT

a) **Bouquet of Financial services:** In order to ensure that all the financial needs of the customers are met, RBI have advised banks to offer a minimum of four basic products, on as Basic Banking Account (previously known as no-frill account): i) a savings cum overdraft account, ii) a pure savings account, ideally a recurring or variable recurring deposit, iii) a remittance product to facilitate EBT and other remittances, and iv) entrepreneurial credit products like a General Purpose Credit Card (GCC) or a Kisan Credit Card (KCC)

IV. TRANSACTIONS

- **Use of Technology:** Recognizing that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas in a viable manner, banks have been advised to make effective use of information and communication technology (ICT), to provide doorstep banking services through the Business Communication (BC) model where the accounts can be operated by even illiterate customers by using biometrics, thus ensuring the security of transactions and enhancing confidence in the banking system.
- **Direct Benefit Transfer (DBT):** The recent introduction of direct benefit transfer, leveraging the Aadhaar platform, will help facilitate delivery of social welfare benefits by direct credit to the bank accounts of beneficiaries. The government, in future, has plans to route all social security payments through the banking network, using the Aadhaar based platform as a unique identifier of beneficiaries. In order to ensure smooth roll out of the

Government's Direct Benefit Transfer (DBT) initiative, banks have been advised to: i) open accounts of all eligible individuals in camp mode with the support of local Government authorities, ii) seed the existing and new accounts with Aadhaar numbers and iii) put in place an effective mechanism to monitor and review the progress in implementation of DBT.

Progress of Financial Inclusion Plan, as on March 2013

A snapshot of the progress made by banks under the FIPs (April 2010 to March 2013) for key parameters, during the three year period is as under:

- A total of 268,454 number of banking outlets have been set up in villages as on March 2013 as against 67,694 banking outlets in villages in March 2010. Total 7404 rural branches opened during the period.

Table 2.3: Progress of Banks in Financial Inclusion

S. N	Particulars	Mar-10	Mar-11	Mar-12	Mar-13
1	Total No. of Branches	85457	91145	99242	101567
2	No. of Rural Branches	33433	34811	37471	40,837
3	No. of CSPs Deployed	34532	60993	116548	-
3	Banking outlets in villages	67694	116208	181753	268,454
4	Banking outlets in Villages with population >2000	37791	66447	112130	-
5	Banking outlets in Villages with population <2000	29903	49761	69623	-
6	Banking Outlets through Brick & Mortar Branches	33378	34811	37471	40,837
7	Banking Outlets through BCs	34174	80802	141136	221,341
8	Banking Outlets through Other Modes	142	595	3146	6,276
9	Total Banking Outlets	67694	116208	181753	268,454
10	Urban Locations covered through BCs	447	3771	5891	27,143
11	No Frill A/Cs (No. In million)	73.45	104.76	138.50	182.06
12	Amount in No Frill A/Cs (Amt In billion)	55.02	76.12	120.41	182.92
13	No Frill A/Cs with OD (No. in million)	0.18	0.61	2.71	3.95
14	No Frill A/Cs with OD (Amt In billion)	0.10	0.26	1.08	1.55
15	KCCs-Total-No. In million	24.31	27.11	30.23	33.79
16	KCCs-Total-Amt In billion	1240.07	1600.05	2068.39	2,622.98
17	GCC-Total-No. in million	1.39	1.70	2.11	3.63
18	GCC-Total-Amt In bilion	35.11	35.07	41.84	76.34
19	ICT Based A/Cs-through BCs (No. in million)	13.26	31.65	57.08	81.01
20	ICT Based A/Cs-Transactions (No. In million)	26.52	84.16	155.87	250.46
21	ICT A/Cs-BC- Transactions - Amt. in Rs billions	6.92	58.00	97.09	233.88
Source: RBI					

- Nearly 109 million Basic Savings Bank Deposit Accounts (BSBDAs) have been added, taking the total no. of BSBDAs to 182 million. Share of ICT based accounts have increased substantially, percentage of ICT accounts to total BSBDAs has increased from 25% in March 2010 to 45% in March 2013.
- Banks provide small over drafts (ODs) in such accounts. Up to June 2012, banks had provided 9.34 lakh ODs amounting to Rs.37.42 crore against 1.31 lakh and Rs 8.34 crore respectively in March 2012.
- Banks have also introduced a General Purpose Credit Card (GCC) facility up to Rs. 25,000/- at their rural and semi-urban braches. The credit facility is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned. Based on assessment of household cash flows, the limits are sanctioned without insistence on security. Interest rate on the facility is completely deregulated. As on March 2013, banks had provided credit aggregating Rs. 76 billion to 3 million GCC accounts.
- Kisan Credit Cards to small farmers have been issued by banks. As on March 2013, the total number of KCCs issued was as 33 million with total amount outstanding to the tune of 2633 billion.

It is important to analyze this progress against the some disturbing trends that were noticed in the run up to the structured Financial Inclusion initiatives that the banks launched since 2010 onwards. *First,* the number of banked centres in the country between 1991 and 2007 had actually come down from 35,236 to 34,471. *Second,* the number of rural branches during the same period had also declined significantly from 35206 to 30409 (refer chart 1). Against this backdrop, the progress made during 2010-13 is certainly remarkable in figures.

2.8.2 Initiation of Financial Inclusion by NABARD

After the 1990s some important steps have been taken for the financially excluded people as launching Self-help groups linkage programmes in 1992 by NABARD. Simplifications of Know your customer (KYC) norms is another milestone. In 1998, Kisan Credit Card has been launched and on the suggestion of NABARD in 2005 General credit card has been launched which facility up to Rs 25000. In January 2006 NGOs, SHGs, and Microfinance Institutions were permitted by RBI. Now MFIs currently cover 8.3 million borrowers. MFIs, Self-help groups (SHGs) also meet the financial service requirements of the poorer segments.

Table 2.4: Progress of SHG bank linkage programme (numbers in millions)

Particulars	2009-10	2010-11	2011-12
Total number of SHGs savings linked with banks	6.95	7.46	7.96
Total savings amount of SHGs with banks (Rs bn)	61.98	70.16	65.51
Total number of SHG credit linked during the year	1.58	1.19	1.15
Total amount of loans disbursed to SHGs during the year	144.53	145.47	165.34
Total number of SHGs having loans outstanding	4.85	4.78	4.35
Total amount of loans outstanding against SHGs	280.38	312.21	363.40
Estimated number of families covered	97.00	97.00	103.00
Source: Status of Micro Finance in India, NABARD			

The SHG-Bank Linkage Programme and other Microfinance initiatives by NABARD has contributed a lot towards financial inclusion process in India. The SHG-Bank Linkage Programme and Microfinance Institutions (MFI)-Bank Linkage Programme have been accepted as effective tools to inclusive growth for extending various financial services to hitherto excluded categories of poor and rural households. As on March 31, 2012, there were more than 7.96 million savings linked SHG and more than 1.15 million credit linked SHG with covering with savings amount of RS 65.5 billion. The phenomenal outreach of the programme has enabled

an estimated 103 million families to gain access to microfinance from the formal banking system as may be seen in the following table.

NABARD has revised the guidelines, for SHG model, popularly known as SHG2 (version 2), which addressed some of the shortcoming of the earlier version. The major features of SHG2 area) more focus on voluntary savings, b) cash credit system of lending over three to five years cycle to minimize the problem of inadequate finance and non-availability of repeat loans, c) enabling creation of Joint Liability Groups (JLGs) within SHGs to scale up economic activities by more entrepreneurial members of the group, d) improving risk mitigation systems by bringing in third party audit, e) building second tier institutions, f) strengthening the self-monitoring mechanism) meeting the training/capacity building requirements of the SHGs.

ITC's e-Choupal infrastructure, with a mission to strength the Farm Sector Development through Public-Private partnership, enables even small and marginal farmers, who have no access to the formal market, to receive relevant knowledge and agricultural extension services. This enables real-time price discovery and improvement in farm productivity and quality, making them more competitive in the national and global market. Presently, ITC has 6,500 e-Choupals covering 40,000 villages and over 4 million farmers. By 2013, the e-Choupal network is expected to cover over 100,000 villages, representing one-sixth of rural India, and create more than 10 million e-farmers. On the other hand, the farmers Club programme promoted by NABARD and implemented by banks, aims to organize farmers to facilitate accessing of credit, extension services, farm technology and markets. While ITC is planning to upscale the e-Choupal initiative, the possibility of collaborating with ITC to provide such infrastructure to about 77,000 Farmers Clubs, could be explored. The synergy from such collaboration could result in sustainable financial inclusion (Chkrabarthy, 2012a).

2.8.3 Micro insurance, IRDA and Financial Inclusion

In India, insurance penetration is at very low level, 4.1% for life and 0.7 for non-life, which is not comparable to any developed or developing countries like US, UK, China and Brazil. It is estimated that about 290 million people who are in proximity to the BPL mark are totally devoid of any insurance. So, India needs to travel a long way for better insurance inclusion.

In order to provide a hedge against these unforeseen risks, micro insurance is widely accepted as one of the essential ingredients of financial inclusion packages. Micro-insurance is usually understood to be the provision of an array of insurance services for low-income households with low premium and low sum assured. Churchill (2006) is of the view that micro-insurance operates by risk-pooling, financed through regular premiums and is tailored to the poor who would otherwise not be able to buy insurance. A recent study by the CGAP (2009) estimates the Indian micro insurance market to have some 14 million adults covered by life micro-insurance in India. In a country with some 120 million families living on less than $2 a day, this is a very small proportion of the potential micro-insurance market. A major share of this market belongs to compulsory credit linked insurance distributed by Micro finance institutions (MFIs), rural banks, and cooperative banks. India being the second most populated country in the world has a large chunk of population living on more than $1 but less than $2 a day. Micro-insurance regulations issued by IRDA have provided a fillip in propagating micro insurance as a conceptual issue. The micro insurance regulations have been made effective from 2005. These regulations are in addition to the obligations for rural and social sector business to be done by all insurers on an annual basis.

In the life micro-insurance segments, there are 16 insurers doing business, out of which 15 are private insurers and LIC, is the only company from public sector. But, LIC plays a vital role in

this segment also, as holds around 90% of market share in premium collections and no of policies issued. The following table provides data on agents, total value of individual and group policies under life micro insurance segment. The table indicates an increasing trend for the first three years in policies, premium and schemes but there is a decline in 2010-11. The reason for such decline may be due to lapse of policies and policies not being renewed by holders.

Table 2.5 : New Business Under Life Micro-Insurance portfolio

Year	Agents	Individual		Group		
		Policies (lakh)	Premium (Rs cr)	Schemes	Premium (Rs Cr)	Lives Covered (lakh)
2008-09	7,250	22	36.6	6,897	206.0	126
2009-10	8,676	30	158.2	5,207	243.4	168
2010-11	10,482	37	130.4	5,469	155.2	153
2011-12	12,797	46	115.7	5,573	109.8	102
Source: IRDA						

The overall performance of micro-insurance in India is not very encouraging. According to a recent study by UNDP (2007), the outreach of micro-insurance is around 5 million people covering only 2 percent of the poor in the country. It shows there is huge potential for micro-insurance market in the country. A conservative estimation of size of micro-insurance market (both life and non life) in India ranges between Rs 62,304.70 to 84,267.55 million (US$ 1,384.55 to 1,872.61 million).

Acharya and Bisht (2012) analyzed the factors behind uptake of life micro-insurance products in Odisha. As part of the study the authors interviewed the senior managers and chief executives of some MFIs who were the distribution channels for life/health micro insurance products, both credit linked and stand-alone. Some beneficiaries were also interviewed in the process. The findings from the interviews of the MFI functionaries indicated conflicts of interests among

different stakeholders. First, risk carriers/insurance companies do not develop products keeping the poor in mind rather they float products with exclusion clauses to minimize claims in general. The kind of products they develop therefore is not socially sustainable. In the business of micro insurance it's only the insurance companies that reap profits not the MFIs or NGO-MFIs. The poor don't benefit since they are forced to buy products that they don't require as such. For instance, they are forced to buy a personal accident policy whereas they need a health insurance policy or a maternity policy. The insurer is not ready to customize a product in health since he sees loss in that and profit in personal accident policy. The MFI is not taken into confidence while underwriting policies in which case the poor's interests are not addressed. Thirdly, the insurers/risk carriers are in the micro insurance business primarily to fulfill the social obligation clause stipulated by IRDA. Finally, the beneficiary is at loss as to the benefits of micro insurance especially when there is a plethora of schemes available without proper awareness on the schemes/products. The study also found that the beneficiaries have negligible knowledge on insurance in general and the policies bought by them in particular (mostly bundled with microcredit). Having analyzed the potential factors that drive the perceptions and therefore the demand a vector of four factors i.e., usefulness, image, individual perceptions, and time emerged as the final factor structure.

2.8.4 Role of PFRDA in promoting Financial Inclusion: As part of the Government's initiative towards 'financial inclusion', the finance ministry has announced a new scheme in 2010 called 'Swavalamban' to encourage the people from the unorganized sector to voluntarily save for their retirement and to lower the cost of operations of the New Pension Scheme (NPS) for such subscribers. Under this scheme, the Government will contribute Rs. 1000 per year to each NPS account. 'Swavalamban' will be available for persons who join NPS, with a minimum

contribution of Rs. 1000 and a maximum contribution of Rs. 12000 per annum during a financial year.

Although the NPS is perhaps one of the cheapest financial products available in the country, in order to make it affordable for the economically disadvantaged, the government in September 2010 introduced a lower cost version, known as Swavalamban Scheme, which enables groups of people to join the NPS at a substantially reduced cost. As per existing scheme under NPS, Swavalamban could be availed either in unorganized sector or in NPS Lite. NPS Lite is a model specifically designed to bring NPS within easy reach of the economically disadvantaged sections of the society. NPS Lite is extremely affordable and viable due to its optimized functionalities available at reduced charges. Under the Swavalamban scheme, the government provides subsidy to each NPS account holder and the scheme has been extended until 2016-17. A customized version of the core NPS model, known as the NPS Corporate Sector Model was also introduced from December 2011 to enable organized-sector entities to move their existing and prospective employees to the NPS under its Corporate Model. All the PSBs have been asked to provide a link on their website to enable individual subscribers to open online NPS Accounts.

- **Micro Pension Model:** A pilot project by NABARD involving an assistance of Rs 2.26 crore was sanctioned to 'Invest India Micro Pension Services (IIMPS) - Micro Pension Model', for propagating and enrolling members for micro pension scheme developed by it in association with UTI AMC.

  Invest India Micro Pension Services (IIMPS) provides economically active but financially excluded urban and rural poor with convenient and secure access to an integrated pension, savings and insurance product solution using a unique, scalable and sustainable technology-led Micro Pension model. IIMPS is the only global firm that is committed exclusively to

educating, encouraging and enabling the working poor to accumulate micro-savings for their old age in a secure, affordable and well regulated environment. In the IIMPS model, low income individuals save on average Rs.200 per month towards their old age while they are young. These monthly savings are distributed between the government's *NPS-Lite Swavalamban* that is regulated by the PFRDA and a mutual fund scheme called *UTI Retirement Benefit Pension Fund.* NPS Lite comes with a lock-in till 55 years of age or 20 years whichever comes first and the mutual fund scheme dissuades early withdrawals through an exit load of 5% in the first year coming down to 1% from the third year onwards till 58 years of age. NPS Lite invests up to 15% in equities and the mutual fund scheme can invest up to 40% in equities. For this, IIMPS charges a fee of Rs.100 in the first year and Rs.80 going forward every year.

The scheme is implemented in eight districts of four States (Odisha, Uttar Pradesh, Bihar and Tamil Nadu) and aims at covering 40,000 persons under old age pension. An amount of Rs 2.03 crore was disbursed by the end of March 2013. Over 20,000 low income rural workers, mainly SHG members, farmers and daily wagers were enrolled under the project and were saving Rs 100-200 per month for their old age.

- **Issues in NPS-Lite of IIMPS**

For investors with a decent flow of income, comfortable level of disposable income and a buffer of emergency fund, a product such as NPS works very well because it calls for targeted investments and locks in your money for that purpose; even a mutual fund works very well for this segment. But when the investors are in the low-income bracket subject to erratic income and expenditure, and debt traps, reaching out with market-linked products

with lock-ins and exit loads as the first set of financial products do seem like good financial planning.

For them, saving for the old age is not paramount, but insuring their health, lives and managing short-term money shocks are. Given the need, the first tranche of products to touch their money should be health insurance, pure life insurance, bank and post office deposits and subsequently Public Provident Fund for long-term savings. These products are needed to build a sound and guaranteed base before any money is put in market-linked products.

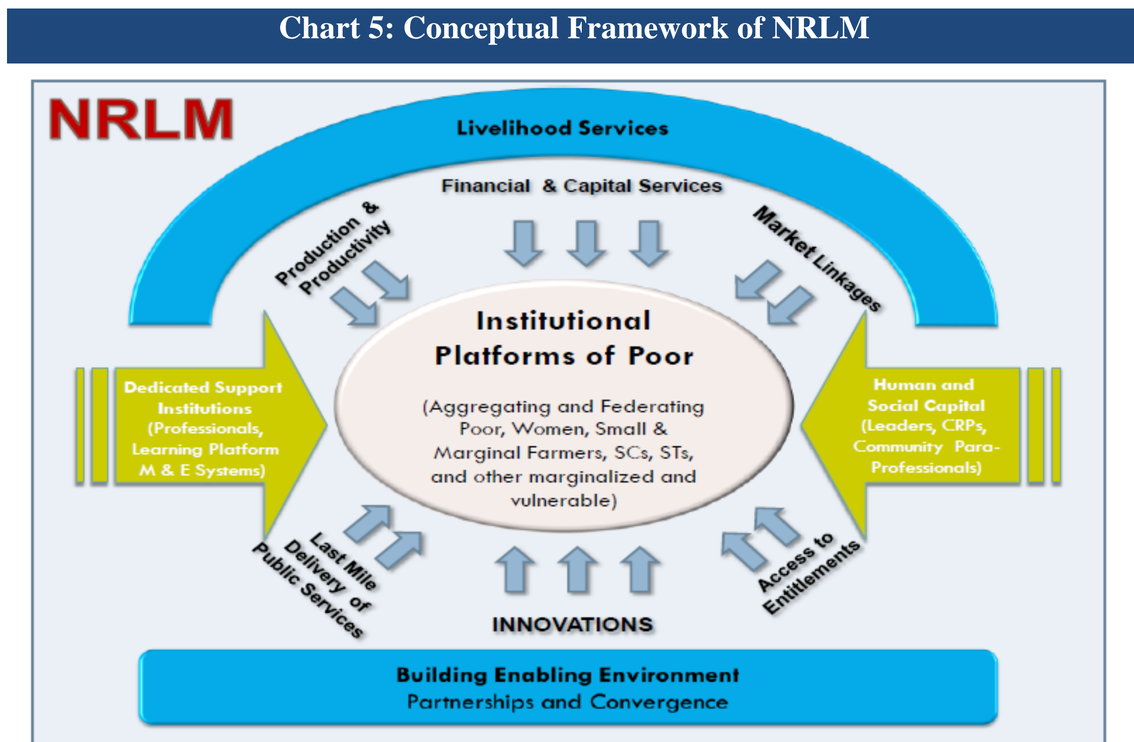
It is well known that, in the long term, equities do outperform other asset classes, but then there is a risk attached. Given this and in the absence of a guaranteed products base, should equity exposure be bundled into the first financial product they buy? And should they be made to lock in their money when they haven't even provisioned for a rainy day? There isn't one product that fulfills all the financial needs and therefore institutions that work in the field of financial inclusion need to adopt a holistic approach. Even banks need to go beyond the mindset of meeting their enrolment targets and they need to reach out to customers with need-based financial products.

2.8.5 Linking of livelihood initiatives with financial inclusion

The Ministry of Rural development, Government of India, has launched a National Rural Livelihood Misson (NRLM) by restructuring the Swarnajayanti Gram Swarozgar Yojna (SGSY) replacing the existing SGSY schemes since April 2013, though the programme was introduced on a piolot basis in June 2010. The main aim of the programme is to reduce poverty numbers through building strong institutions of the poor, particularly women, and enabling these institutions to access a range of financial services and livelihoods services.

NRLM is promoting a major shift from purely 'allocation based' strategy to a 'demand driven' strategy wherein states have the flexibility to develop their own plans for capacity building of women SHGs and Federations, infrastructure and marketing, and policy for financial assistance for the SHGs. NRLM will provide continuous support to SHGs, and their federations. This was missing in SGSY. Thus, basically, NRLM talks about rural livelihoods through Self Help Groups (SHG). The conceptual framework of NRLM is as under:

Chart 5: Conceptual Framework of NRLM



Source: Programme implementation plan, NRLM, Ministry of Rural Development, GoI.

As discussed in the Chapter 2, financial inclusion (access to finance at an affordable cost) is critical for poverty reduction. In this context, NRLM strategy for financial inclusion aims to make the poor as the preferred clients and banks feel it as a profitable business model. The strategy options for the NRLM are proposed around a simple triad reflecting interplay of three forces viz., incomes, costs and risks, affecting the livelihoods of the poor households.

This programme (NRLM) will be in continuation with the SHG-Bank linkage model of NABARD. It will be implemented in federal structure (district, State & Centre). In the state, State Rural Livelihood Mission (SRLM) would do the advocacy with the banks to promote SHG credit linkage. In continuation with the RBI's financial inclusion drive, State Level Bankers' Committee (SLBC) to constitute an exclusive sub-committee for SHG bank linkage and financial inclusion and the functions of the sub-committee would be planning, coordination, monitoring and review of financial inclusion and credit linkages. Finally, at the state, SRLM) will be the sole responsible agency to drive this programme.

Issues in NRLM Implementation

NRLM promises a lot with regard to creation and strengthening of rural livelihoods but it suffers some serious shortcomings, which if not addressed are likely to see it move in the same path as the IRDP, SGSY and/or other programs. So, herewith, we are presenting critical issues that raise the risk of failure with regard to implementation of the NRLM:

- Though, SHGs have contributed to financial inclusion, relying solely on SHGs might be a limitation for the implementation of the programme. As not everyone in rural area is a member of an SHG and not everyone may desire to become a member of a SHG. Given the changing nature of our society, the choices and information available before individuals the sustainability of such programmes in the medium and long term will be determined by sustained activities of SHGs. Since NRLM is trying to build on the existing SHG network it's important to activate the inert SHGs, bring in quality work to SHGs that are income generating.

- Since the membership in SHGs keep changing and new SHGs come up over emphasis of NRLM on SHGs could result in exclusion (rather than inclusion) of the rural poor. In the process people who are not inclined and/or unable to participate through SHGs may be excluded. The question raised here is “Can NRLM d focus on the household as the primary target of the program?”.
- Thirdly, NRLM may also focus on rural MSMEs, which, as the experiences of many countries suggest, can play a major role in enabling and sustaining inclusive growth in rural areas. MSMEs are the growth engines in emerging and developing economies and they need to have targeted interventions. One of the key areas that NRLM could focus upon is the creation of a stronger and vibrant ecosystem for agro MSMEs in various value chains.
- Fourthly, the strategy of NRLM is too broad. Rather than attempting to do a whole lot of things across the board, it may be better if the NRLM learns from its past experiences (such as the IRDP or SJSY) and focuses on areas that could impact livelihoods of large number of rural people so as to generate quick wins for the program as well as get the initial thrust and momentum, so critical for medium and long term success.

Even after 64 years of independence, we are still riddled with problems of basic services pertaining to rural livelihoods and financial inclusion. A serious introspection of the reasons behind the current state is called for. Is it a problem of design or implementation? Both success and failure with respect to design and implementation might help in solutions. There seems to be a plethora of schemes and provisions by different players including the government.

2.9 Urban Financial Inclusion in India

In India the financial inclusion efforts of the Government and other regulators such as, RBI, IRDA, PFRDA etc, is largely remained focus towards the rural poor, as a greater number of populations are still remain unbanked in the village areas. But in urban areas, we feels that the reach of banking network is quite high, as around 36% of the total branch network is located in urban & metro areas, which are offering their products and services to only 30% of the total population in the country. However, the ground realities are quite shocking, as problem of exclusion is widespread even in urban areas, especially, for the disadvantaged and low-income groups, despite there being no dearth of bank branches.

In the last 3-years (FY10 to FY13), banks have opened 26,696 BC outlets in urban areas, as part of the financial inclusion drive. But, the achievement is far from what was hoped for. Many of the urban poor still have no access to formal financial products and services like savings, credit, remittance and insurance, forcing them to depend on informal sources to meet their personal, health, and livelihood-related needs. Not surprisingly, they struggle to repay such borrowings, which further impede their ability to escape the vicious circle of poverty.

2.9.1 Reasons & Possible Solutions to Urban Exclusion

Presently, urban population of our country is growing much faster than the growth of total population. The most important reason may be the migrant workers. Every year, a large number of people migrate from villages to cities in search of a better life for themselves and their families. They take up non-contractual and non-permanent jobs of vendors, porters, hawkers, construction workers, domestic workers, rickshaw pullers, etc. Among the urban poor, the migrant workers' group is being affected most due to the problem of financial exclusion in urban areas. These workers in urban areas mostly comprise people from low-income households who

generally leave their village homes in search of better income and employment opportunities. Many of these people work and live at their work sites and are paid daily wages. They need a secure place to keep their savings and the facility to remit small amounts of money at frequent intervals. In most of the migration corridors, the migrants have outstanding loans at their origin points (rural home), mainly from informal sources, and the remittances are the major source of loan repayment.

By 2030, it is estimated that around 40% of Indians will be living in cities and towns compared to the current proportion of 30%, which would also lead to an increase in the number of urban poor, currently pegged at 80 million by NSSO. This large section of the population lacks access to even the most basic banking services like deposits and remittances. However, in view of the non-permanent nature of their occupations, they frequently shift base within city or even across cities. Bankers are generally found to be shy in providing them banking services, for obvious reasons. The main reasons for the exclusion in urban areas may be due to the following reasons, such as: (i) inability to produce adequate documentation, (ii) guarantor or introducer, (iii) lack of knowledge and (iv) due to their temporary earnings. If some of them holds account, they don't know about the remittance facilities offered by banks, so, do not use them effectively. As a result of lack of financial literacy and general apathy, even those who have money continue to keep their savings either at home or prefer to participate in informal savings schemes like chit fund.

In our primary survey, we have also observed that the urban poor's don't have accounts with any bank; most of them are going once in a month to their village to give money to their dependants. In their needy time, they borrow from family, friends, local money lenders, mainly because of speed (24x7x365) and ease to get money, even at exorbitant interest rates of 5-8 per cent per month as the lender understand their financial situation and constraints. Besides, the indifference

of the urban poor to the formal sources of finance, despite these being less costly, is also attributable to the attitude and mindset of the service providers, which needs to be facilitating and supportive Experience suggests that the financially excluded population is more comfortable tapping the informal sources to finance their needs, which are much more ‘flexible’ and ‘convenient’.

2.9.2 Solutions to Urban Exclusion

Therefore, there is an urgent need for the financial institutions to study the informal systems strong points and that need to be incorporated into the practices of the formal service providers to the extent possible. Another solution may be the product innovation in financial services, keeping in view the life cycle needs of the urban poor. Banks should innovate to create demand-oriented savings, credit and remittance products that are customized to the lifestyle patterns and income streams of the urban poor. Offering micro-saving products, per se, to meet the savings needs of these groups, might not be enough. Innovative financial products offering possible investment opportunities, besides catering to the savings needs, have to be thought of for bringing the urban poor into the banking system. Insurance offers protection to assets created under credit programmes and protects savings from being wiped out by shocks arising out of sickness, death, accidents or asset loss caused by fire, drought, floods and riots. The section of the urban poor, who are determined to save regularly, even with their low earnings, should be provided an investment option that fetches reasonable rate of return on their savings, without exposing them to significant risks. Mutual funds and pension schemes for the unorganized sector, customized to the financial needs of the poor, have to be developed, which will give a fixed return as they don’t understand the market complexities.

In appropriate, customized delivery channel is equally crucial in urban areas. South Africa's *E-Bank Plan* demonstrates how a commercial bank can bundle services for low-income clients. Its uniqueness lies in its focus on sensitivity to the needs of the basic banking customer, which led to creation of a new product providing a cost efficient delivery mechanism. The idea was to offer an integrated combination of product and delivery features, including user friendly, conveniently located branches, by leveraging on technology. E-banks are conveniently located in high-traffic areas in colourful, well-designed, user-friendly kiosks. Instead of relying on traditional advertising methods, E-Bank has used market presence, life insurance and prizes to generate word-of-mouth advertising. The approach is providing product and delivery features that are valuable enough to make the low-income clients willing to pay ATM transaction fees slightly above the market norm and high enough to cover banking costs.

Bringing the urban poor into the mainstream of the financial system can act as an important gateway for financial inclusion. Rolling out of an innovative financial product, delivered through a user friendly channel, is central to achieving financial inclusion. This has to be seamlessly integrated with a strategy to improve the financial literacy of the targeted groups. Only then will we be able to avoid the problem of low level of transactions in the newly opened accounts, which we are currently facing in our financial inclusion efforts in the rural areas.

Most importantly, society has to radically change its attitude towards labour and the people providing us manual services. Every task has its dignity and we must respect the efforts put in by these groups of people and their contribution in making our lives comfortable and hassle-free.

2.10 Recent Policy Initiatives and Passed Bills to induce Inclusion

2.10.1 New Bank Licensing in Private Sector: The Finance Minister in his Budget speech 2010-11 had indicated that new bank licenses would be issued for rapid expansion of banking for

financial inclusion. Accordingly, RBI has come out with final guidelines for New Bank Licences, allowing business houses, state-run enterprises and non-banking finance companies to set up banks, in a bid to extend banking services to half of the population that is excluded from them. Highlights of the guidelines are: (i) Promoters should bring a minimum paid-up capital of Rs.500 crore, (ii) Promoters to hold minimum 40% of paid-up capital locked for five years, (iii) The bank shall open at least 25% of its branches in unbanked rural centers (population up to 9,999 as per the latest census), (iv) The bank shall comply with the priority sector lending targets and sub-targets as applicable to the existing domestic banks, and (v) Bank should maintain a minimum CAR of 13% for a minimum of 3 years. Further, RBI has empowered itself to reject those whose 'business model' and 'culture' are not in line with banking. Further, the Banking Laws (Amendment) Act 2012 strengthens the regulatory powers of the RBI and paves the way for grant of new bank licences by the RBI.

RBI's decision to allow new players in the banking sector has received big thumbs up from Indian industry. The drive has resulted in 26 companies, including Tata Sons, Aditya Birla, Reliance Capital, Bajaj Finserv, L&T Financial Holdings, IFCI and India Post, applied for banking licences. RBI is in the process of constituting an external committee headed by Dr. Bimal Jalan and the committee will be composed of individuals with impeccable reputation. This committee will screen licence applicants after an initial compilation of applications by the RBI staff. The external committee will make recommendations to the RBI governor and deputy governors, and will propose the final slate to the Committee of the RBI Central Board. The final licence is likely to be issued before January 2014.

New banks are required to increase banking access, reach and penetration, while expanding geographic coverage. The financial inclusion programme, which seeks to bring every Indian

household under the organized banking arm, would mean more banks have to come in the fray. That's because RBI has mandated that all the new players must open one branch in rural areas for every four they set in urban areas. Besides, increased participation from the private sector will mean more competition, which will ultimately benefit customers.

If new banks do more of what the existing banks are doing the inclusion will be widened. RBI has insisted that the new banks need a thrust on financial inclusion. The final guidelines do not make inclusion a central point of discussion. The first set of licences offered to the private sector in 1993 brought in fundamental changes, state-of-the art technology, a better customer interface, professionalism and data-driven decision making. It had a positive effect on the banking sector and can be termed as game changing.

It's difficult to speculate the likely impact on financial inclusion of these new banks. Will any of the new players come out with a business plan that will appeal to RBI on this initiative? RBI has made it clear that the new banks would induct new processes and technology, improve efficiency, enlarge the capital base to meet the credit needs of the economy and generate huge employment opportunities in the country. But the question still remains on the ability of these new banks in accomplishing the desired branch expansion and inclusive growth when the performances of the existing private sector banks are not encouraging.

2.10.2 Microfinance Bill & Andhra Pradesh Crisis

The expansion of MFIs in India was more in Andhra Pradesh and Tamil Nadu by the year 2010 with a major share of borrowers and loans. Most of the MFIs belonged to the profit making types. A bad coincidence of around 200 suicides in a particular year in AP alone was related to multiple MFI loans and defaults by borrowers. Arunachalam (2011) pointed these suicides as an

effect of multiple causes including that of multiple lending and borrowing which the MFI sector both profit making and non-profit making encouraged. There was no credit bureau functioning at that time to check these multiple lending and borrowing. Easy availability of loans made households borrow from different MFIs for different purposes including consumption smoothening. This credit led growth collapsed when MFIs found the credit sub-prime in nature. The Andhra Pradesh state government and other activists blamed the MFIs for fuelling such unhealthy expansion in the sector that resulted in suicides. The Govt. of A.P. then brought in regulations to control MFI activities in general and prevented forcible recovery of loans from poor borrowers. MFIs faced defaults and could not further expand their base which affected their growth. Banks and other funders stopped lending to MFIs which choked the flow of resources to MFIs. The Govt. of A.P. passed the Andhra Pradesh Microfinance Ordinance 2010, which included a number of measures that greatly restricted microfinance institutions' operations in the state. Following the AP Microfinance Ordinance, the Reserve Bank of India (RBI) created a committee, the Malegam Committee, to make recommendations for the regulation of the MFI sector. This committee aimed to address the antecedents that led to the crisis, including coercive collection practices, usurious interest rates, and selling practices that resulted in over-indebtedness. The Malegam Committee recommendations saw the light in January 2011. These recommendations were "broadly accepted" by the RBI in May 2011, though specific guidelines were only released regarding which microfinance institutions qualify for priority sector lending at this time. Priority sector lending is a government initiative which requires banks to allocate a 40 percentage of net bank credit to investment in specified priority sectors at a reduced interest rate. The A.P. crisis had a contagious effect on other states too wherein it was difficult for MFIs to mobilize resources for lending to their clients. This situation was also exploited by new MFI

entrants by way of encroaching in to exiting clientele of the old MFIs. In view of this a study was conducted and compiled by Deepti K C, Acharya D and Others in 2011 on behalf of the Centre for Microfinance, IFMR. This study covered seven states and thirty two MFIs. The study mainly focused on: 1) MFIs' view towards Malegam Committee recommendations and RBI regulations 2) MFIs' responses to RBI guidelines on clients choice of payment, loan usage and annual household income of clients 3) MFIs' responses to RBI's caps on interest rate and margin 4) Current funding scenario among the MFIs. The MFIs' concerns were that the Malegam committee recommendations created confusion among the bankers because of which the funding scenario dried up. The Malegam Committee's proposal that companies require a minimum net worth of Rs. 15 crore to register under suggested new category of Non Banking Finance Company (NBFC) would affect medium and small sized MFIs. As per data provided by Micro Credit Ratings International Ltd, only 26 MFIs have net worth of more than Rs. 15 crore and together these 26 firms have a market share of 85% of the total loan portfolio. The question now is what would happen to the remaining for-profit MFIs, which have net worth of less than Rs. 15 crore.

MFI Bill & It's Impact

After this crisis, to regulate this growing sector, Government passed a bill, namely Microfinance Institutions (Regulation & Development), on 22 May 2012. The bill empowers RBI to regulate the micro-finance industry and fix interest rate ceiling on loans. Further the expression "micro finance services" is defined in the Bill as providing micro credit, collection of thrift, remittance of funds, insurance and pension services. It also provides for regulation of activities like micro-credit, thrift, pension or insurance services and remittances of funds by microfinance institutions (MFIs). MFIs must have a minimum net-owned fund of Rs 5 lakh and be registered with RBI.

This bill supersedes all State-level legislation, including the controversial October 2010 Andhra Pradesh law that threw the industry into a crisis. In addition, a Micro-Finance Development Council will be set up to advice the Government on formulation of policies, schemes and other measures required in the interest of orderly growth and development of the sector with a view to promote financial inclusion.

This Bill will provide a respite to the microfinance industry and is expected to help ease the fund flow to the sector. Since, the bill will provide a constitutional framework for the microfinance industry and also gives greater powers to RBI. Though RBI has already started regulating MFIs registered as non-banking financial companies (NBFCs), the others are also likely to come under its purview after the passing of the legislation.

It's clear from the above that the key players in financial inclusion activities have been subject to policy uncertainty primarily due to the way the different sectors have evolved over a period of time and due to some unforeseen consequences of activities in the sector and set of govt. policies being implemented from time to time.

2.10.3 Pension Fund Regulatory and Development Authority (PFRDA) Bill

The Parliament on 04 September 2013 passed the Pension Fund Regulatory and Development Authority Bill (PFRDA Bill), thereby making PFRDA a statutory authority. The main objective of the bill is to provide a structure to plan for old age income security through its New Pension Scheme (NPS). NPS is a defined contribution scheme and is based on the principle that 'you save while you earn' especially for retirement. With increasing life expectancy and changing fabric of traditional family structure, the Bill is expected to deepen pensions and annuity market for ensuring old age financial security.

As of now, NPS is mandatory for all Central Government employees (except armed forces) entering service with effect from 01 April 2004. Twenty six States have already notified NPS for their employees (except West Bengal and Tripura). NPS has been launched for all citizens of the country including unorganized sector workers, on voluntary basis, with effect from 1 May 2009. Further, to encourage the people from the unorganized sector to voluntarily save for their retirement, the Government launched the co-contributory pension scheme titled "Swavalamban Scheme" in the Budget of 2010-11.

- The passage of the pension bill will be positive for financing the fund requirements for the infrastructure sector. Pension funds by design are vehicles to create financial claims on future output. Hence, when pension funds are channelized in infrastructure, it creates a bi-directional positive feedback loop where supply infrastructure boosts further GDP growth. The total investment in infrastructure sectors in the Twelfth Plan (2013-17) is estimated to be Rs 55.7 lakh crore (debt plus equity), and the pension funds are expected to contribute at least Rs 1.5 lakh crores in debt component.

Table2.6 Availability of debt by sources of funds (Rs lac crore)		
Commercial banks	11.65	51%
NBFC	6.19	27%
Pension and/ life insurance	1.50	7%
ECB	3.31	15%
Total	22.65	100%
Source: Planning Commission		

This estimated contribution by pension funds towards infrastructure is on the lower side given the potential for developing pension market in India. However, as on 14 August, 2013, the number of subscribers under NPS was 52.83 Lakh with a corpus of only Rs 34, 965 crore.

Hence, convincing pension funds to invest in infrastructure as an asset class will be a challenge. There is need for a separate policy to address this aspect of risk perception.

2.9 Challenges to Financial Inclusion

The current policy objective of inclusive growth with financial stability cannot be achieved without ensuring universal financial inclusion. Financial Inclusion of the unbanked masses is expected to unleash the hugely untapped potential of the sections of the society that constitute the bottom of the pyramid. However, in pursuing the FI mission, the normal banking model has been found wanting in terms of cost, scalability, convenience, reliability, flexibility and continuity. To ensure that the banks give adequate attention to financial inclusion, they must view this as a viable business proposition rather than as a corporate social responsibility or a regulatory obligation. For the business to remain viable it would be important to focus on increasing usage of existing banking infrastructure which would happen only if the banks can offer an entire bouquet of products and services to the holders of the large number of basic bank accounts opened during the last three years as also to the new customers that the banks acquire. If the dream of universal and a meaningful financial inclusion has to be turned into reality, then going forward, we would need to focus on the following issues:

Strategy for further financial inclusion

- **Leadership:** Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.
- **Diversity:** Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of

affordable services (savings, credit, payments and transfers, insurance), as well as a diversity of service providers.

- **Innovation:** Promote technological and institutional innovation as means to expand financial system access and usage, including addressing infrastructure weaknesses.
- **Protection:** Encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers and consumers.
- **Empowerment:** Develop financial literacy and financial capability.
- **Cooperation:** Create an institutional environment with clear lines of accountability and coordination within government, and also encourage partnerships and direct consultation across government, business and other stakeholders.
- **Knowledge:** Utilize improved data to make evidence-based policy, measure progress, and consider an incremental "test and learn" approach acceptable to both regulator and service provider.
- **Proportionality:** Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.
- **Framework:** Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk based AML/CFT regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.
- **Innovative product lines & processes:** Banks have to look at their policies and procedures to develop new product lines rather than merely adopting the complex products of urban

India in the rural milieu. Providing simple and basic banking services in the form of deposit account with remittance services and small credit facility would ideally suffice for bringing the unbanked into the folds of banking system.

2.11. Summing up

The financial inclusion initiatives have made substantial progress in the last few years. However, given the diversity and size of our country much more needs to be done. It's evident from the above discussion that policy initiates started with a focus of enrolment into banking followed by savings mobilization and credit to needy and underprivileged. Apart of direct credit by govt. supported schemes and SHG bank linkage programmes there was a catalytic role played by the Govt. in supporting the MFI structure. The focus of services has also been diversified into insurance, pension, remittances by mobile phones, and literacy/education. The progress has largely been in deposit and credit activities. The other services have a still a long way to go despite efforts by different stakeholders.

For instance based on the experience of countries like Kenya, and the massive growth and expansion of mobile phone in the country, there is need for scaling up the existing models of mobile-led banking for financial inclusion like the services rendered by EKO and SBI TINY practiced in some parts India. Banks have a social responsibility and in this context, financial inclusion to extend the access of credit to weaker sections is important. Inclusive growth and financial inclusion has assumed a prime place in the public policy for achieving sustainable high growth in India. If the country has to record double digit growth on a sustainable basis for the next 10 or 15 years, it is imperative that poor, underprivileged and low income groups should have access to banking and financial services. Availability of easy and cost-effective banking

services for savings, investment and credit enables people to break out of poverty by using the credit for various productive and consumption purposes.

The strategic shift to sustainable financial inclusion, viewing it as a viable business proposition has been made possible by the availability of Information and Communication Technology which has facilitated penetration into widespread unbanked areas in a cost effective way. In the following chapters an empirical attempt is made to verify the extent of financial inclusion, and critically examine supply side issues using secondary data on financial services and qualitative case studies.

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CHAPTER III
FINANCIAL INCLUSION IN INDIA:
AN EMPIRICAL ASSESSMENT - 2007-08 TO 2011-12

3.1. Introduction

In this chapter an attempt is made to assess the progress on financial inclusion drawing heavily upon the definitions mentioned in Chapter II. Therefore, an annual data set for major Indian states on the SHG Bank Linkage programme and Micro Finance Institutions are utilized for constructing a Financial Inclusion Index (FIIND). Data on number of SHGs having savings accounts, number of SHGs with loan disbursements, SHG savings, SHG loans, number of MFIs and MFI loan outstanding are collected for available number of years i.e. 2007-08, 2008-09, 2009-10 and 2011-12. The data on SHG related variables are collected from annual reports of NABARD. Data on MFIs are collected from the state of the sector reports on Micro finance in India published by Sage India and The Bharat Microfinance report-quick data 2012.

3.2. Indices on Financial Inclusion: Some Previous Studies

There have been different attempts by different authors and some institutions to measure the depth of financial inclusion using aggregate data on banking indicators. The most recent index on financial inclusion is the *CRISIL-Inclusix 2013*. CRISIL Inclusix is India's first comprehensive measure of financial inclusion in the form of an index. To quote the report, "It is a relative index that has a scale of 0 to 100, and combines three very critical parameters of basic banking services - branch penetration (BP), deposit penetration (DP), and credit penetration (CP) - together into one single metric. For each of these parameters, CRISIL evaluates financial inclusion at the national/ regional/ state/ district level vis-à-vis a defined ideal. A CRISIL Inclusix score of 100 indicates the ideal state for each of the three parameters". The all-India

CRISIL Inclusix score of 40.1 (on a scale of 100) is relatively low as per the report which implies under-penetration of formal banking facilities in most parts of the country as claimed by the report.

In another study *Sarma (2012)* computed a multidimensional index of financial inclusion using data on banking penetration, availability of services, and usage for 62 countries for the period 2004-2010. The findings indicate different levels of inclusion for different countries the commonality being an improvement over time during 2004-2010. The study finds that barring few exceptions high income countries tend to be high on financial inclusion.

Chattopadhyay (2011) developed an index of financial inclusion (IFI) using data on three dimensions of financial inclusion with an objective to monitor the progress of policy initiatives for financial inclusion in a country/state over a period of time. The results indicated that in the group of 18 districts in West Bengal for which a 3-dimensional IFI was estimated by using data on 3 dimensions of financial inclusion, Kolkata yielded the highest value of IFI followed by Darjeeling district. Only one district, viz., Kolkata had higher IFI with IFI of 1.0. All other districts had low IFI values, varying between 0.0 and 0.3.

A study by ICRIER *(2009)* placed India at a low 29th rank (out of 55 countries) on an Index of financial inclusion with a value of 0.2. The index used information on three comparable dimensions across the countries covered - (i) accessibility (measured by penetration of the banking system, number of bank accounts per 1,000 people), (ii) availability (number of bank branches/ATMs per 100,000 people) and (iii) use of banking services (volume of credit plus deposits relative to GDP). The study also highlighted the correlation between human development and financial inclusion. With low financial inclusion the author concluded that it was not surprising that the human development index of India, ranked 119 (UNDP, 2009) out of

169. Hence, it becomes clear that improving the nation's financial inclusion status will require a concerted effort from all stakeholders - the government, regulators, banks and others.

3.3. Financial Inclusion Index (FIIND)

In this section FIINDs have been estimated employing the same methodology as in Sarma (2012) for major Indian states for four different years. To assess the supply side strength in promoting financial inclusion the focus has been on variables specific to the low income or under privileged. As widely claimed in the literature the SHG bank linkage programme and the Micro Finance Institutions (MFIs) have been trying to reach the vulnerable by providing credit and savings. Therefore the data on number of SHGs having savings accounts, number of SHGs with loan disbursements, SHG savings, SHG loans, number of MFIs and MFI loan outstanding are used as different dimensions to calculate FIIND.

3.3.1. Methodology

Inclusion can be measured from different dimensions. We have estimated here with the multi dimensional approach discussed in Sarma (2012). These dimensions may be number of SHGs, total number of branches and total amount of savings and loan portfolio in a year. To derive the state wise financial inclusion index (FIIND), first we have estimated each dimension index followed by the final inclusiveness index.

The dimension index (D_i) has been calculated using the following formula, which measures the states i[th] dimension inclusion index.

$$Di = wi\ \{\frac{Ai - mi}{mi - Mi}\}$$

Where,

w_i is the weight assigned to the dimension i, indicating the relative importance of the dimension i in quantifying the inclusiveness. $0 \leq w_i \leq 1$. For simplification, we have taken w_i as 1.

A_i = Actual value of dimension i

m_i = lower limit on the value of dimension i

M_i = upper limit on the value of dimension i.

The formula ensures that the value of D_i will be in the range $0 \leq D_i \leq w_i$. The higher the value of D_i means the higher the state's achievement in dimension i. If n dimensional financial inclusion case is considered then a state's achievement in these dimensions will be represented by a point X = (D1, D2,....Dn). To compute the final FIIND, the following formulae are employed:

$$X1 = \frac{\sqrt{D_1^2 + D_2^2 + \ \ + D_n^2}}{\sqrt{w + w_2^2 + \ \ + w_n^2}}$$

$$X2 = 1 - \frac{\sqrt{(w1 - D1)^2 + (w2 - D2)^2 + \ \ + (wn - Dn)^2}}{\sqrt{w + w_2^2 + \ \ + w_n^2}}$$

FIIND = – [X1 + X2]

FIIND is a simple average of X1 and X2, thus incorporating distances from both the worst point and the ideal point. Since, w_i is 1 then the IFI would be:

$$FIIND = \frac{1}{2}\left[\frac{\sqrt{D_1^2 + D_2^2 + \quad + D_n^2}}{\sqrt{n}} + \left\{1 - \frac{\sqrt{(1-D1)^2 + (1-D2)^2 + \quad +(1-Dn)^2}}{\sqrt{n}}\right\}\right]$$

Thus FIIND is being calculated using seven dimensions (D1 to D7) of an inclusion, such as, no of SHGs and amount of deposits in saving accounts, no of SHGs and amount of loan disbursed, No of MFI clients and total MFI loan outstanding and number of commercial branch offices. The study is focused on state-wise progress in financial inclusion based on the above parameters, for the period 2007-08 to 2009-10 and 2011-12. Due to the data unavailability in some indicators, we are not able to derive the inclusion index for the year 2010-11. We have included 30 states and union territories for computation of the index and compare the indices for the sates over a period of time.

3.3.2. Results and Discussion

The final inclusion index is being reported in the following table, which presents a state-wise index of 30 states for the period of four years, i.e., 2007-08, 2008-09, 2009-10 and 2011-12. The index of inclusion lays in the range of 0 to 1, higher the index value, better is inclusion. The ranks are being assigned on the basis of index value.

- The results shows that Andhra Pradesh is placed at the no 1 position in all the years but the level of inclusion is being increased over the year from FY08 to FY12. The states like Tamil Nadu, West Bengal, Maharashtra, Karnataka and Odisha have consistently performed well during the study period, though there is a little variation in ranks among the states.

- The north-eastern states are under performed as the index is at a very low level. The data also substantiates such finding since the level of banking facilities have not penetrated well in these regions. There are few SHGs in these states.

Table 3.1: State wise FIIND

Index of Inclusion for Various States

States	2007-08		2008-09		2009-10		2011-12	
	FIIND	Rank	FIIND	RANK	FIIND	RANK	FIIND	Rank
Andaman and Nicobar	0.027	20	0.002	29	0.002	29	0.003	29
Andhra Pradesh	0.640	1	0.818	1	0.893	1	0.915	1
Arunachal Pradesh	0.003	28	0.046	19	0.058	19	0.004	28
Assam	0.057	14	0.037	20	0.049	20	0.138	13
Bihar	0.098	11	0.115	12	0.138	11	0.189	8
Chhattisgarh	0.053	15	0.065	15	0.066	16	0.071	18
Goa	0.019	23	0.015	23	0.015	23	0.013	23
Gujarat	0.145	9	0.121	11	0.153	9	0.160	10
Haryana	0.047	17	0.054	16	0.065	17	0.073	17
Himachal Pradesh	0.026	21	0.028	21	0.030	21	0.034	21
Jammu & Kashmir	0.067	13	0.071	14	0.077	14	0.026	22
Jharkhand	0.048	16	0.052	17	0.067	15	0.075	16
Karnataka	0.307	3	0.408	3	0.424	4	0.532	2
Kerala	0.160	8	0.164	8	0.185	8	0.242	6
Madhya Pradesh	0.106	10	0.127	9	0.152	10	0.160	9
Maharashtra	0.204	7	0.341	5	0.429	3	0.413	4
Manipur	0.004	27	0.004	27	0.004	26	0.005	25
Meghalaya	0.007	25	0.011	24	0.014	24	0.009	24
Mizoram	0.004	26	0.006	26	0.004	27	0.004	27
Nagaland	0.003	29	0.003	28	0.003	28	0.005	26
New Delhi	0.046	18	0.052	18	0.063	18	0.077	15
Orissa	0.211	6	0.220	7	0.264	6	0.237	7
Punjab	0.025	22	0.028	22	0.029	22	0.096	14
Rajasthan	0.098	12	0.125	10	0.138	12	0.149	12
Tamil Nadu & Pondicherry	0.339	2	0.432	2	0.599	2	0.159	11
Tripura	0.010	24	0.009	25	0.013	25	0.034	20
Uttar Pradesh	0.240	5	0.235	6	0.256	7	0.347	5
Uttarakhand	0.033	19	0.108	13	0.122	13	0.045	19
West Bengal	0.252	4	0.407	4	0.418	5	0.437	3

Note: States are ranked based on the FIIND values

- In all most all states, the FIIND values have increased over the period, which might imply that the banks and other financial institutions are doing very well in implementing the inclusion initiatives of the states and central Government.
- The FIIND of Tamil Nadu and Pondicherry is indicating a downward movement. We hope Tamil Nadu is performing well but due to Pondicherry the index is low. Due to data unavailability, these two have been clubbed and treated as one state.
- Andhra Pradesh, Karnataka, West Bengal, and Uttar Pradesh are the top performers in the year 2011-12 and the worst performers are Nagaland, Mizoram, Arunachal Pradesh, and Andaman-Nicober.
- Goa has a lower value of FIIND probably because the SHG and Micro finance activity as indicated by the chosen parameters are lower than that of the other states. It may also be due to higher urbanization and the inclusion index that captures urban activities might show higher inclusion status. For instance the CRISIL Inclusix(2013) finds Goa to be one of the top five performers. Goa's score is 72 for 2011. The index in this study considers only SHG and MFI parameters and therefore Goa shows a lower score.

3.4. Financial Inclusion (FIIND) and Reduction in Rural Poverty

Financial inclusion is important for growth and reducing inequality and poverty. In a report on 'Financial Inclusion Plays vital Role in Reduction of Poverty, Inequality and Stimulation of Job Creation', by the World Bank it has been said that the transformative power of financial inclusion in South Africa should not be underestimated. Improved access to finance by poor households and micro enterprises can unlock income earning opportunities and self-reliance for many'.

In this study, we made an attempt to see the correlation between financial inclusion and poverty reduction. . The state-wise poverty numbers i.e. percentage of population below poverty line are being taken from RBI Data base for the year 2011-12 and inclusion index is being taken from our FIIND state-wise index (refer table 5). As FIIND inclusion index is based on SHGs, which are mostly located in rural areas, we have used the rural poverty numbers in percentage terms.

Table 3.2: Percentage of Population Below Poverty Line in 2011-12

States	Rural	Urban	Combined
Andaman and Nicobar	1.57	0.00	1.00
Andhra Pradesh	10.96	5.81	9.20
Arunachal Pradesh	38.93	20.33	34.67
Assam	33.89	20.49	31.98
Bihar	34.06	31.23	33.74
Chattisgarh	44.61	24.75	39.93
Goa	6.81	4.09	5.09
Gujarat	21.54	10.14	16.63
Haryana	11.64	10.28	11.16
Himachal Pradesh	8.48	4.33	8.06
Jammu & Kashmir	11.54	7.20	10.35
Jharkhand	40.84	24.83	36.96
Karnataka	24.53	15.25	20.91
Kerala	9.14	4.97	7.05
Madhya Pradesh	35.74	21.00	31.65
Maharashtra	24.22	9.12	17.35
Manipur	38.80	32.59	36.89
Meghalaya	12.53	9.26	11.87
Mizoram	35.43	6.36	20.40
Nagaland	19.93	16.48	18.88
New Delhi	12.92	9.84	9.91
Orissa	35.69	17.29	32.59
Punjab	7.66	9.24	8.26
Rajasthan	16.05	10.69	14.71
Tripura	16.53	7.42	14.05
Uttar Pradesh	30.40	26.06	29.43
Uttarakhand	11.62	10.48	11.26
West Bengal	22.52	14.66	19.98
Source: RBI			

In our view, a better inclusion in a year may not being results in poverty reduction in the same year. Here, we have computed the correlation between the poverty numbers for the year 2012 with the FIIND index numbers for the year 2007-08, 2008-09 and 2009-10. The correlation Matrix is:

Table 3.3: Correlation Matrix: Poverty ,Financial Inclusion				
	FIIND08	FIIND09	FIIND10	FIIND12
P12	-0.04	-0.04	-0.03	-0.02
Note: P12: Rural Poverty for 2011-12 and FIIND: Financial Inclusion Index for respective years				

The result indicates that there is a negative correlation between the rural poverty numbers and the financial inclusion, which implies better the inclusion, lower the poverty in the states.

3.5. Concluding Remarks

To sum up in this chapter an attempt has been made to construct a financial inclusion index(FIIND) for thirty states employing parameters relating to SHG Bank linkage programme and Micro Finance Institutions for four recent years. The choice of the years is largely driven by availability of consistent data on chosen parameters. The states like Tamil Nadu, West Bengal, Maharashtra, Karnataka and Odisha have consistently performed well during the study period, though there is a little variation in ranks among the states. In all most all states, the FIIND values have increased over the period barring few exceptions which might imply that the SHG bank linkage programme along with the Micro Finance institutions have performed well in financial inclusion initiatives with respect to deposit and credit.

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CHAPTER IV
FINANCIAL INCLUSION AND SUPPLY SIDE CONSTRAINTS : SOME ISSUES AND EVIDENCE

4.1 Introduction

In this chapter the supply side constraints to financial inclusion are discussed in terms of few cases. To begin with the data on non performing assets(NPA) due to SHG portfolio of banks are analyzed. Then a case study of interviews of some branch managers of rural public sector branches is presented to understand the possible bottlenecks from the supply side. A case study of mobile banking initiative by the State Bank of India called SBITINY is also presented. Finally, the reasons behind individuals choosing informal sources of borrowing rather than formal sources are analyzed by conducting a case study of hundred households belonging to low income groups in two villages of Rangareddy district of Andhra Pradesh.

4.2 SHG-Bank Linkage Programme and Financial Inclusion

In the last two decades, the major institutional innovation in India for improving financial access and usage for the poor and marginalized sections of the population has been the SHG-Bank Linkage Programme (SBLP). This was an outcome of pilot projects during the 1980s for improving access of rural poor to formal institutional financial services. For the banks, it was a way of reducing their transaction costs by dealing with groups of people rather than individuals, reducing the credit risks through peer pressure and making people save. Subsequently in the year 1992, the National Bank for Agriculture and Rural Development (NABARD) started a pilot project of linking SHGs with branches of banks across the country. The project provided a cost-effective SBLP model for providing financial services to the underserved poor. Being a 'savings-first, credit later' model, credit discipline became a norm for SHGs and 'social collateral' made

them bankable. The model was also successful in providing solution to the twin problems faced by banks, i.e., low recovery of loans in rural areas and high transaction costs in dealing with small borrowers at frequent intervals. One of the major positive impacts of the SBLP was social and economic empowerment of the membership.

Table 4.1: SHG-Bank Linkage Progress (numbers in millions)

Particulars	FY10	FY11	FY12
Total number of SHGs savings linked with banks	6.95	7.46	7.96
Total savings amount of SHGs with banks (Rs bn)	61.98	70.16	65.51
Total number of SHG credit linked during the year	1.58	1.19	1.15
Total amount of loans disbursed to SHGs during the	144.53	145.47	165.34
Total number of SHGs having loans outstanding	4.85	4.78	4.35
Total amount of loans outstanding against SHGs	280.38	312.21	363.40
Estimated number of families covered	97.00	97.00	103.00

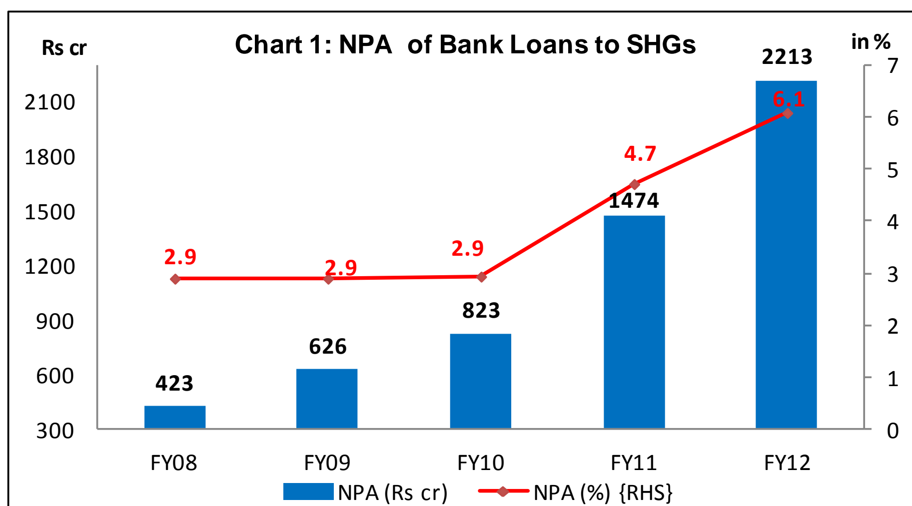
Source: Status of Micro Finance in India, NABARD

Despite the noteworthy accomplishments of SHGs (refer table 1), certain issues, such as, inadequate outreach in many regions, delays in opening of SHG accounts and disbursement of loans, impounding of savings by banks as collateral, non-approval of repeat loans by banks even when the first loan was repaid promptly, multiple membership, borrowings by SHG members within and outside SHGs, adverse consequences of unhealthy competition between NGO promoted SHGs and Government promoted/subsidy oriented SHGs and limited banker interface and monitoring continued to affect the programme in many areas. While the basic tenets of the SHGs being savings led credit product remain true even today, recent developments have given rise to the need for crucial changes in the approach and design of SBLP to make it more flexible and client friendly.

The revised NABARD guidelines, popularly known as SHG2 (version 2), have sought to address some of the shortcomings of the earlier version. The major features of SHG2 are : (a) more focus on voluntary savings; (b) cash credit system of lending over three to five years cycle to minimize the problem of inadequate finance and non-availability of repeat loans; (c) enabling creation of Joint Liability Groups (JLGs) within SHGs to scale up economic activities by more entrepreneurial members of the group; (d) improving risk mitigation systems by bringing in third party audit; (e) building second tier institutions; (f) strengthening the self-monitoring mechanism and (g) meeting the training/capacity building requirements of the SHGs.

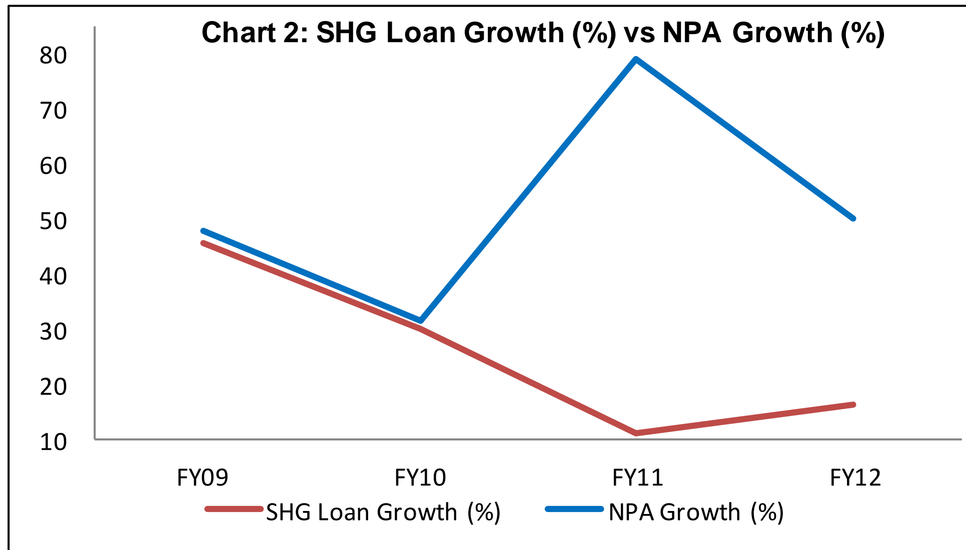
4.3. Rising Non-Performing Assets (NPAs) of Bank Loans to SHGs

In the past, a number of studies quantified the excellent repayment performance of above 90%, which was one of the driving factors

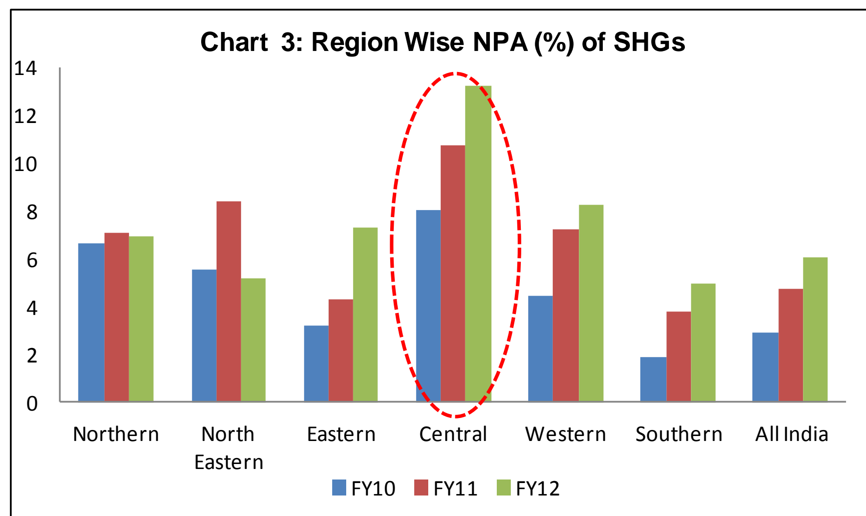


that influenced banks to actively participate in the programme. However, with fast expansion in terms of numbers and geographies, delinquencies are creeping into SBLP. As per NABARD data the Non-Performing Assets of banks against loans to SHGs has gone up from Rs 422.93 crore (2.9% of NPA to O/S SHG loans) in 2007-08 (1st time banks reported to NABARD) to Rs 1474 crore (4.7% of NPA) in 2010-11 and further deteriorated to Rs 2,213 crore (6.1% of NPA) in 2011-12.

In the recent years, it is observed that the y.o.y. growth in NPA is much higher than the loans growth to SHGs (refer chart 2). This is an adverse situation and banks may voluntarily abstain from the SHG portfolio, which we observed during the field study also.



The trend of increasing NPAs is observed across all regions of the country (refer chart 3). Among the regions, southern region with a NPA of 4.98% (3.79% last year) was the lowest while Central Region with an alarming 13.2% (10.7% last year) was the highest. The higher level of NPAs against the SHGs in central and northern regions needs to be addressed as these are the states where the financial inclusion are at the lowest levels.



There is an urgent need to probe the causes for delinquencies in SHG lending for redesigning the strategies of the SHG movement. Otherwise, the continuously increasing NPAs in this programme may force bankers to go slow on SHG lending, which in turn may affect the financial inclusion drive as SBLP is one of the important tools for financial inclusion.

4.3 State Level Analysis on Supply Side Constraints

In the following table the NPA in percentage terms are presented for all states with their ranks for five years i.e. 2008-2012. The ranking is done in terms of lowest NPA to highest NPA.

State Wise Analysis of NPAs against Bank Loans to SHGs										
STATES	FY12	RFY12	FY11	RFY11	FY10	RFY10	FY09	RFY09	FY08	RFY08
Andaman & Nicobar	4.84	9	0.00	1	0.23	1	0	1	11.80	14
Andhra Pradesh	3.46	5	2.02	2	1.29	5	0.5	2	8.01	7
Arunachal Pradesh	16.24	26	6.51	16	3.99	14	5.3	16	122.94	27
Assam	4.59	7	8.31	19	5.29	20	9.8	25	11.40	12
Bihar	6.18	13	4.07	8	5.27	19	7.2	20	8.43	8
Chhattisgarh	5.19	11	9.53	23	6.26	22	8.6	21	2.55	4
Goa	1.13	1	3.59	6	0.84	3	3.1	9	0.10	1
Gujarat	4.80	8	4.60	10	3.19	10	2.5	6	13.45	16
Haryana	6.28	14	3.95	7	5.06	17	4.1	13	17.93	21
Himachal Pradesh	10.38	21	7.31	17	5.12	18	5.9	19	1.67	3
Jammu & Kashmir	3.73	6	4.27	9	5.54	21	2.5	7	1228.20	28
Jharkhand	7.66	17	4.94	11	5.05	16	5.5	17	11.68	13
Karnataka	3.35	4	2.98	5	2.01	6	0.8	3	8.59	9
Kerala	9.04	19	8.61	22	2.52	8	3.5	10	4.84	5
Madhya Pradesh	22.45	28	11.28	25	8.2	24	8.6	22	44.55	26
Maharashtra	8.89	18	7.81	18	4.68	15	5.8	18	14.87	18
Manipur	20.72	27	17.40	27	12.99	28	11.7	27	16.10	20
Meghalaya	33.08	29	8.45	20	10.16	26	18.1	28	40.53	25
Mizoram	5.12	10	52.06	28	16.09	29	0.0	29	6.50	6
Nagaland	12.28	23	14.26	26	12.49	27	11.3	26	25.93	24
New Delhi	16.12	25	5.76	14	0.45	2	4	12	0.20	2
Odisha	11.86	22	6.24	15	3	9	4.2	14	9.20	11
Punjab	5.50	12	5.30	12	3.74	12	2.6	8	2880.50	29
Rajasthan	6.49	15	8.49	21	8.1	23	8.6	23	15.17	19
Tamil Nadu & Pondichery	9.58	20	1193.00	29	3.95	13	3.5	11	13.65	17
Tripura	2.79	2	2.16	3	1.01	4	1.7	4	8.80	10
Uttar Pradesh	12.51	24	11.08	24	8.79	25	9.4	24	21.54	22
Uttarakhand	7.08	16	5.61	13	3.26	11	4.7	15	21.83	23
West Bengal	3.11	3	2.28	4	2.19	7	2.0	5	12.41	15
Note: Rank: 1 is good (low NPA %) & Rank: 29 is Bad (high %)										

The figures for 2012 show Goa, Tripura, West Bengal, Kerala, Andhra Pradesh and Jammu Kashmir to be the top five states having lower NPAs with ranks one to five. States having higher NPAs with ranks 25 to 29 are New Delhi, Manipur, Madhya Pradesh, Meghalaya, and Arunachal Pradesh. The ranks have fluctuated for the states during the five years of our analysis. It's a bit puzzling to see rising NPAs of the SHG portfolio of banks which raises several questions on sustainability of SHGs towards inclusion efforts. In view of this we conducted a case study of rural bank branches by having in depth interviews with rural public sector bank branch managers to understand the reasons behind rising NPAs and other supply side constraints. The following section presents some of these findings.

4.4. Supply side difficulties: Some Primary Evidence from Bank Branches

The focus of the study being supply side constraints one needs to assess comparatively the reasons behind success/failure of policy implementation which further provides some insights to delve into possible improvements in the approach of policy makers towards financial inclusion. With this objective at hand a case study has been planned wherein branch managers of some rural branches of public sector banks of Andhra Pradesh and Odisha are being interviewed with a semi structured questionnaire (given in Appendix-I) to understand the implementation difficulties of different inclusive policies. The choice of states is driven by different FIIND values i.e. 1 for Andhra and 7 for Odisha. The NPA ranking has been stable for Andhra Pradesh varying between 2 to 7. But the NPA ranking for Odisha has declined and it has varied between 3 to 22. The fluctuation in ranks for different years for Odisha calls for further investigation. Therefore few rural bank branches are chosen in Odisha given the duration of the project i.e. six months. The choices of districts are driven by relatively low credit deposit ratio with regard to all commercial banks.

In all interviews are conducted with seven bank branch managers of rural branches of SBI in Jagatsinghpur and Cuttack districts of Odisha. With conditions of anonymity and with

managers' consent interviews are conducted to understand the difficulties faced in implementing inclusion programmes so that supply side constraints can be generalized. It is observed that the main credit portfolio of these branches is agriculture. However, some branches do have other business segments like home loan etc., but its share is very negligible. The other portfolios like pension, insurance is non-existent but branches are selling insurance guarantees to house loan customers as a combo product. The total credit portfolio of these branches is very low compared to the deposits. The main reasons of low credit off-take are lack of good quality loan proposal, and low repayment capacity of the customer. Most of the loans demanded by customers are only for consumption purposes. The NPA level is very high and is the biggest concern for the officers in operations.

In SHG linkage programme performance, the branches seem to be doing a great job but due to shortage of staff they are not able to counsel more people to scale up. In all branches, there is no specialized officer for agricultural loan. Some executives are concerned about profitability and transaction cost in such accounts. They are worried about the repayment capacity of the SHG groups as most of these fall in NPA category due course. Few SHG accounts approach for second loan to the bank. The NPA seems to be rising because the loans sanctioned are not used for productive purposes. Branches also fail to monitor proper use of loans due to human resource constraints. Eventually the NPAs of the current year and fresh loans sanctioned the next year become the March end phenomenon or target achieving phenomenon. The loans are sanctioned every year to meet targets like following typical incremental approach. The same takes place on recovery front too wherein minimal recovery takes place before March end of every financial year. The branch wise data as reported by the branches are reported which are to be analyzed with caution. The effective inclusion doesn't take place because the promotional role is missing

out here in nurturing the SHGs and their loans. The dropout rate of existing SHGs in seeking fresh loans seems to be high. To sum up one finds the branches trying hard to implement policies flowing from the top without a resilient mechanism developed to handle the realities. The problem also gets aggravated due to wrong loan seeking attitudes on part of SHGs and interference of local political and social institutions.

Branch Wise Data of Jagatsingpur District of Odisha : March 2013 (Rs lakh)																
				Total Branch NPAs		SHG Loan				NO FRILL A/C (amt in thousands)						
										BC		BRANCH		TOTAL		
Branch Name	Total Deposits	Total Advances	Agri. Loan	%age	Outstanding	No of Acs	Amt of loan	NPA Amt	NPA %	No	Amt	No	Amt	No	Amt
BALIKUDA	4061	492	260	7.76	38.16	51	19.55	2.16	11.05	324	2.27	490	598.34	814	600.6
BHITAR ANDHARI	1698	945	532	45.4	428.95	170	124.98	30.32	24.26	71	0	2805	964.08	2876	964.08
ERSAMA	2405	357	136	3.26	11.63	8	4.56	0	0	0	0	320	287.41	320	287.41
KUJANGA	3002	400	131	12.31	49.24	45	13.54	2.06	15.21	1	0.8	65	120.55	66	121.34
MANDASAHI	2273	770	348	61.12	470.71	106	49.84	31.86	63.92	0	0	147	166.63	147	166.63
RAGHUNATHPUR	3240	730	357	22.6	165.04	71	33.74	10.58	31.36	380	3.06	213	352.19	593	355.25
RAHAMA	5146	1846	596	51.18	944.88	181	90.77	58.96	64.96	0	0	6	4.29	6	4.29
SAMPUR SAB	2074	874	348	36.34	317.63	229	94.33	42.7	45.27	522	516.32	990	447.25	1512	963.57

The managers are of the view that KYC requirements for no-frill accounts are not problematic but the human resource is a constraint. As per the statistics, the progress of no-frill account is very low, as Bank now removes the minimum balance for all accounts to zero. In rural branches the KYC norms also liberalized, so, there is no need for a separate account termed as no frill, which should not exceed deposits of Rs 50,000 and credit of Rs 100,000 in a year. However, as per RBI and Govt. regulations the Bank is opening some accounts in these schemes.

Branch Wise Data of Rangareddy District of Andhra Pradesh : March 2013 (Rs lakh)															
				Total Branch		SHG Loan				NO FRILL A/C (amt in thousands)					
										BC		BRANCH		TOTAL	
Branch Name	Total Deposits	Total Advances	Agri. Loan	%age	Outstanding	No of Acs	Amt of loan	NPA amout	NPA %	No	Amt	No	Amt	No	Amt
ADIBATLA	1818	2119	1677	3.08	65.33	812	1119.45	6.57	0.59	0	0.00	3	1.38	3	1.38
DABILPUR	1459	2147	1404	7.49	160.87	296	604.96	4.29	0.71	1055	32.24	63	99.08	1118	131.32
IBRAHIMPATNAM	1560	589	481	2.43	14.31	NA				0	0.00	13	6.25	13	6.25
KOMPALLE	4538	56796	0	0.01	16.74					7	0.48	2	0.50	9	0.98
NAGARAM	2977	1121	30.00	0.00	0.00					0	0.00	1	0.17	1	0.17
TURKAYAMJAL	1113	1008	285	0.54	5.49					1371	251.54	11	5.6	1382	257.14

The technological initiatives made by Government and RBI to include more persons into the banking channels is not successful in these areas, due to low knowledge of technology and also

lack of ATMs. BC model is also not so successful due to low incentives and better position of branches to the villages. In mobile banking and IMPS channel, the progress is also negligible. The customers and the branch level executives do not seem to have an idea of Interbank Mobile Payment Service (IMPS) developed and operated by National Payment Corporation of India (NPCI).

As evident in the questionnaire the primary survey of branch level executives focuses on supply side constraints with regard to technology bottleneck, top-down approach in policy making resulting in implementation issues on ground, process/procedure related bottlenecks, and promotional activities by branches to ensure proper utilization of the service rendered especially those of loans.

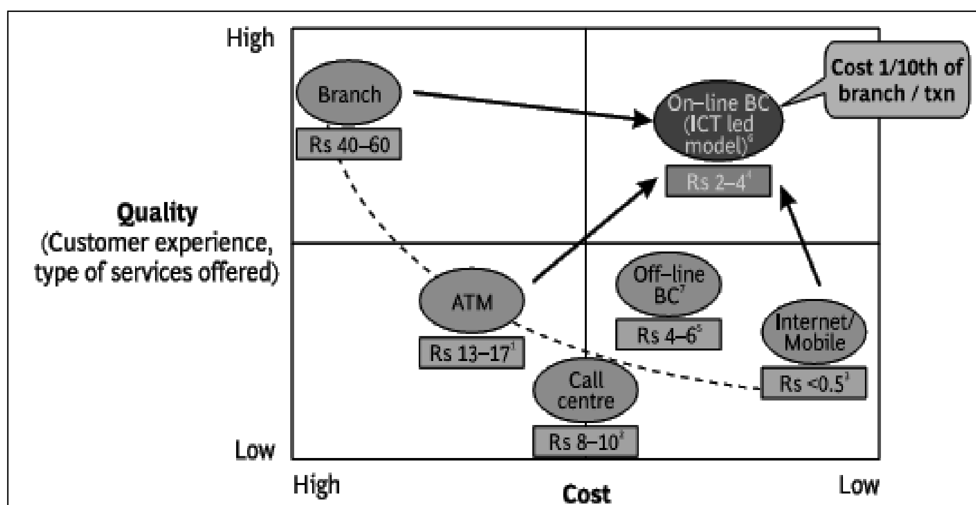
4.5 Cost Effectiveness of Banking Channels for Financial Inclusion

Five alternate channels for transactions ATM, internet, mobile, call centre and POS, have all reached critical mass in the Indian market and are poised for rapid development in terms of depth of penetration and quality of service. We have estimated (*SBI Research Report)* estimated that mobile phones will lead the way in the future. India has 900 million plus mobile subscribers, but only 240 million individuals with bank accounts. For a population of 1.2 billion, this translates into 75% having a mobile phone and only 20% having a bank account. Hence, financial inclusion using mobile phones is a key focus area.

Innovation in mobile phone technology is taking place at a rapid pace. It is conceivable that within next few years we will have cheap phones with Near Field Communication (NFC) technology built in to facilitate Peer-to-Peer (P2P) money transfer almost instantaneously. At this stage it is also conceivable that most of the payers at POS will be using mobile phones instead of cards to make payments. Many small daily P2P transactions like payments to sundry vendors

will move from cash to mobile phone. Given that mobile transactions cost a fraction of ATM or branch transaction, the enormous productivity enhancement that will accrue to banking system can hardly be overemphasized. The advent of 3G in mobile telephony in India can open many avenues for richer service delivery. Priority customers, who are otherwise not viable for a dedicated relationship manager, can get “face to face” financial planning advice on their mobile devices from a set of centrally located advisors. According to the Report, Internet and mobile banking channels of banking delivery are the most cost effective (< 0.5 paisa) mode for the banks, while branch services provide the most qualitative services and are instrumental in getting the customers. But branch banking is high-cost as banks are incurring around Rs 40-60 for each transaction. The most efficient mode of delivery is ‘online BC, ICT led models’, which shows high quality customer experiences and low cost for banks, as shown below:

A report by the *BCG report,* internet and mobile banking are most cost effective (<50 paisa per transaction) while branch services are instrumental in getting customers. But branch banking is high-cost as banks incur around Rs 40-60 for each transaction. The most efficient mode of delivery is ‘online BC, ICT led models’, which offers high quality of customer services also.



Source: Source: Being Five Star in Productivity, BCG, FICCI and IBA Report, August 2012

4.6. Mobile Banking: A Case Study of SBI TINY

In this section a case of SBI TINY, a mobile based money remittance service is presented to highlight a positive aspect of supply side towards inclusion and also to see how specific factors like role of an agent/individual play an important role in taking inclusion forward. The behaviour of the users of this service is compared with a group of users of any other cash management service to know the differences. The case study is supplemented with funding from a project carried out by Acharya et al (2012) on "Financial Literacy, Technological Acceptance, and Financial Inclusion: A study of Urban Users in Hyderabad". Of late mobile banking has drawn attention of all players all over the world. The following box presents some of the successful stories across countries.

Mobile Banking: Examples				
	South Africa	Philippines	Kenya	Zambia
Name of the service (brand)	Wizzit, MTN Mobile Money	SMART Money, G-Cash	M-Pesa	Celpay
Starting Year	2005	2000, 2004	2005	2002
Model Driver	JV of Bank and Third Party (Wizzit); Bank and Telecom Company (MTN)	Telecom Company	Telecom Company	Third Party
Who Can Use	Unbanked (Wizzit); Banked/Unbanked (MTN)	Unbanked	Unbanked	Banked
Cash Access Mode	Bank and/or third party (Wizzit); Bank (MTN)	Bank	Bank and Telecom Company Network	Telecom Company Network
Deposit Ownership	Bank	Bank	Bank	Telecom Company
Documentation Needed	Valid ID (Wizzit); No ID for Unbanked and Valid ID and Address Proof for Banked (MTN)	Valid ID (SMART Money, G-cash)	Valid ID	Valid ID
Primary Area Served	Wizzit: Rural and Semi-Urban MTN: Urban	G-Cash: Rural SMART money: Rural and Urban	Both Rural and Urban	Urban

Fee Structure (deposit)	Wizzit: 1 % of the amount MTN: bank dependent	1 % of the amount	Nil	Not Free (details N/A)
Fee Structure (withdraw)	Wizzit: Fixed Charges MTN: bank dependent	SMART: fixed ATM charges, G-Cash (1% of the amount)	Based on the amount	Not Free (details N/A)
Money sending to non-users	Wizzit: Yes MTN: partial (select agents/subscribers)	No	Yes	No
Money receiving from non-users	Wizzit: Yes MTN: partial (select banks in select countries)	SMART: Yes, G-Cash: No	No	No
Account Opening Fee	Wizzit: Fixed amount MTN: bank dependent	Nil	Nil	Nil

Source: Adapted from Mishra Vishal and SS Bisht(2013), "Mobile Banking in a Developing Economy: A Customer Centric Model for Policy Forumation", Telecommunications Policy, 37, 503-514.

Brief on the SBI TINY Services

The State Bank of India, with its 16,000+ branches in rural and urban India, and 'A Little World' (ALW) have launched a mini banking system called 'SBI Tiny' reaching beneficiaries at their door step. The SBI Tiny card provides easy banking services for underprivileged communities. For this programme the SBI ties up with NGOs that play the role of 'Customer Service Providers' (CSP) or rather work like a local branch. The aim of this scheme is to cover as many of the poor unbanked population in the country as possible. The SBI Tiny account does not require `KYC` (or Know Your Client) documents and can be opened with zero balance. In this account one can deposit or withdraw between Rs.10/- to Rs.10,000/- the upper limit for this account is Rs.50,000/-. The SBI Tiny card provides more accessibility and customer trust, making it easier to build relations with its customers. This card which functions like a normal savings bank account, helps to encourage and further savings habits. It also offers easy "Money Transfer Service" to anywhere in India. ZERO-Mass a NGO is playing the role of a Business Correspondent, with an aggregator account at SBI. ZERO –Mass also coordinates the Local

level programs with local NGOs and District Administration. It also coordinates activities relating to aggregation of Customer Service Points, Cash Management Service and MIS tools to CSPs, Help Desk in local languages for Customer Service Points, Hands-on Operator Field Training for, Enrollment of customers, Financial Inclusion Transactions, Non-Banking Transactions etc. A Little World is the technology partner which is responsible for Front-end and back-end technology, 24x7 operations and system maintenance, Enrollment and Personalization system for issuance of cards, MIS and Reporting., Technology support to Business Correspondents with a focus on Increasing the viability and sustainability of the project.

THE DATA AND RESPONDENTS

The unit of analysis in this case study is the end user of SBI TIMY money remittance service in Hyderabad urban. The samples of 300 mobile based remittance users are drawn from the users[1] of this new initiative from the urban dwellers of Hyderabad who are residing in the areas where the SBI TINY services are introduced. Another 300 users are treated as the base for the study as those who do not use any of these services but might use any other cash management service.

The respondents for the study are identified by the investigators and they are interviewed at their residences or points of service use. Informed consent is obtained in each case.

[1] New for the consumer. It is important to note that the service might have been in existence but the respondent has not used it for himself.

Measures and Statistical analysis

A set of simple questions are developed to measure literacy focusing on numeracy part of the literacy. Other items are used to operationalize the constructs mainly adapted from previous research. These items relate to financial and social empowerment and service specific quality of life. Scores for financial literacy are generated by filtering the right and wrong answers to the questions asked in these sections of the questionnaire. Other constructs are measured using multiple items and on a five-point scale (e.g. 1=strongly disagree; 5= strongly agree).

In our sample we have interviewed 300 users of SBI TINY money remittance services and 300 users of other cash management services from different areas of urban Hyderabad.

Results: Mean Scores		
	Control group	SBI Tiny
Financial Literacy	5.99	6.10
Empowerment	6.16	6.25
Service specific quality of life	97.26	97.43

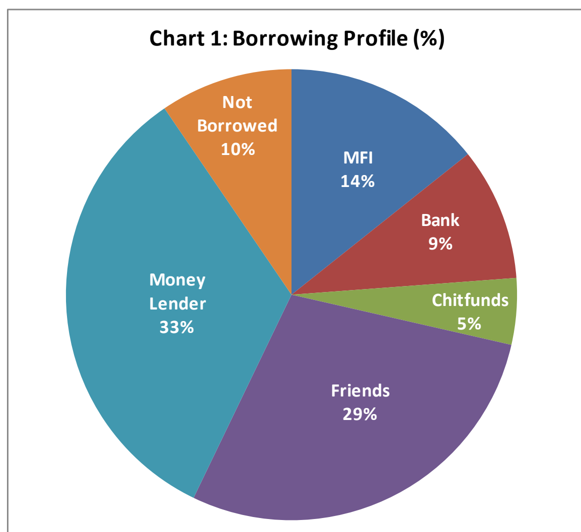
As evident in the box above users of SBI TINY possess higher scores in financial literacy, empowerment, and service specific quality of life compared to the control group that doesn't use this particular service. This preliminary evidence is in favour of transformation in quality of life when appropriate financial service is introduced like SBI TINY which includes more people. The interactions with the users also reveals that remitting money through this mobile enabled technology saves time and transaction cost. The specific factor that is observed in the field is due to the individual with a commitment to take this service to as many as possible. This is observed in the Balanagar branch of SBI TINY and with the agent Mr Satyanarayana.

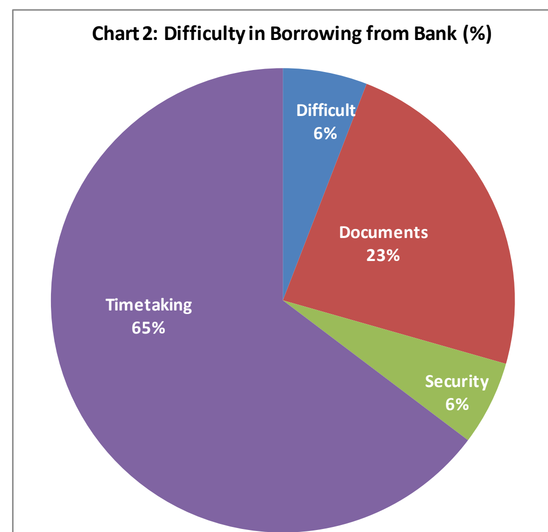
4.7. Preferring Informal sources of Borrowing: Results from A Small Survey

In this section results from a survey of three villages in Ranga Ready District of Andhra Pradesh is presented to understand why people do prefer informal sources rather formal sources of borrowing like banking. A total of 100 families are being surveyed with a structured questionnaire (Appendix II). The results of the survey are being analyzed below:

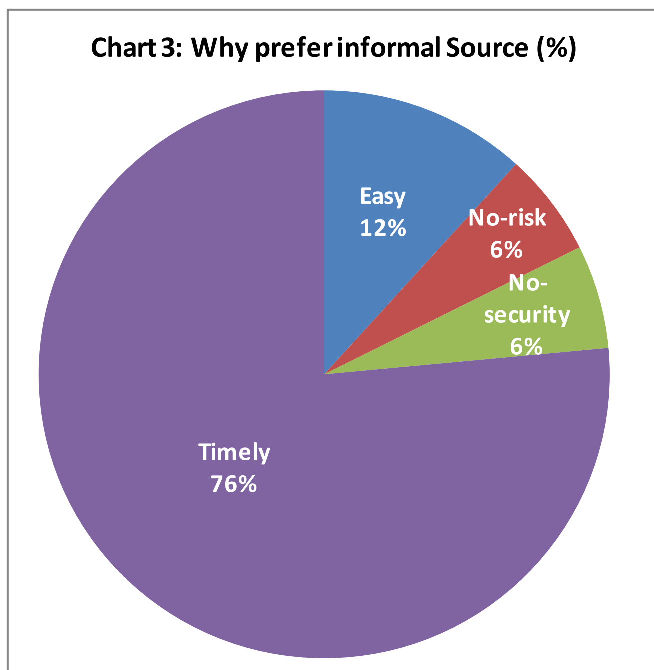
Banking Habits: Survey Results (%)		
	Yes	No
Peoples Having Bank Account	87.50%	12.50%
Membership in MFI	12.50%	87.50%
Borrowing in last 1 year	82.61%	17.39%

The inclusion level is high, as 87.50% of people are having bank account and some of the people are also membership in MFI institutions. But, when we see the borrowing profile, the story is very depressing; as there are only 9% of the sample people taking loan from Banks and 14% from MFIs. However, the percentage borrowed from money lender is much higher at 33%. The main obstacles to borrow from banks are: *i)* time taking procedure, *ii)* needs collateral security and *iii)* a number of documents required.





The survey found that people are borrowing from informal sources mainly due to timely and easy availability of money at their rainy day. The people are not much bothered about the interest rate offered by the informal sources, though it is higher than formal channels. Easy, timely and collateral free loans are preferred to bank loans by the borrowers even in these surveyed areas that are not far from bank branches. This small survey might go against the macro figures arrived in earlier chapters but it speaks volume of efforts warranted further towards financial inclusion.



4.8. Concluding Remarks

This chapter attempted a discussion on supply side constraints focusing on three issues. First, rising NPAs on SHG portfolio of banks was traced for four different years for thirty states. The fluctuating NPA for different states was substantiated by the field observations and interviews of rural bank branch managers. Secondly, the case study of SBI TINY mobile remittances sketched a positive picture of inclusion. Lastly, the preference for informal sources by borrowers from villages and the factors behind the same was discussed based on a primary survey of 100 households from 2 villages of Rangareddy district of Andhra Pradesh.

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CHAPTER V
SUMMARY, CONCLUSION & POLICY SUGGESTIONS

5.1. Introduction

Of late the debate on financial inclusion has gained momentum all over the world. India has been no exception to the debate. There has been an explosion of efforts towards financial inclusion by all the stakeholders including the Govt., and non-government. Given the vast need for financial inclusion in this populous country intellectual efforts to understand the problems from both demand and supply sides have also been undertaken in different forms including research. The present study is small step in this direction which is more of an introspection to delve into critical issues relating to financial inclusion in India. Given the time of about six months the study uses both secondary data and some primary evidence to answer an overarching question i.e., “Has financial inclusion happened in India?”.

5.2. Findings of the Study

The Indian financial sector is primarily dominated by the banking industry, as they hold around 75% of the financial assets of the system. So, banks play a critical role in promoting the financial inclusion in the country, as we have followed the bank-led model to financial inclusion. In this report, we made an attempt to address both the demand side and supply side issues relating to financial inclusion. In chapter II, a critical review of all the efforts made by Government, RBI, IRDA, NABARD and PFRDA is being made. A summary of the financial inclusion plan (FIP) of banks in the last 5-years is also attempted. The numbers show that the efforts to financial inclusion are achieved to some extent in general and in savings and credit in particular.

To analyze the inclusion at the state level, we have constructed a Financial Inclusion Index (FIIND) state-wise by taking the annual data set of 30 Indian states on the SHG Bank Linkage

programme and Micro Finance Institutions (MFIs). Data on number of SHGs having savings accounts, number of SHGs with loan disbursements, SHG savings, SHG loans, number of MFIs and MFI loan outstanding are collected for available number of years i.e. 2007-08, 2008-09, 2009-10 and 2011-12. The data on SHG related variables are collected from annual reports of NABARD. Data on MFIs are collected from the state of the sector reports on Micro finance in India published by Sage India and The Bharat Microfinance report-quick data 2012. To construct the index, we have estimated here with the multi dimensional approach discussed in Sarma (2012). The index of inclusion in the range of 0 to 1 implies, higher the index value, better is inclusion. The results shows that Andhra Pradesh is placed at the No 1 position in all the years but the level of inclusion is being increased over the year from FY08 to FY12. The states like Tamil Nadu, West Bengal, Maharashtra, Karnataka and Odisha have consistently performed well during the study period, though there is a little variation in ranks among the states. The north-eastern states are under performed as the index is at a very low level. The data also substantiates such finding since the level of banking facilities have not penetrated well. There is very little number of SHGs in these states. In all most all states, the FIIND values have increased over the period, which might imply that the banks and other financial institutions are doing very well in implementing the inclusion initiatives of the states and central Government. However, the FIIND of Tamil Nadu and Pondicherry is indicating a downward movement. We hope Tamil Nadu is performing well but due to Pondicherry the index is low. Due to data unavailability, these two have been clubbed and treated as one state.

Further, to see the real impact of financial inclusion on the rural poor people, we looked the rural poverty numbers for the year 2011-12 (data available). It shows an improvement in the last five years. To analyze this empirically, we computed the correlation between the estimated Financial

Inclusion Index (FIIND) with the rural poverty with a lag. The result indicates that there is a negative correlation between the rural poverty numbers and the financial inclusion index. So, better inclusion may lead to lower poverty numbers.

The focus of the study being supply side constraints one needs to assess comparatively the reasons behind success/failure of policy implementation which further provides some insights to delve into possible improvements in the approach of policy makers towards financial inclusion. With this objective at hand a case study is done wherein branch managers of some rural branches of public sector banks of Andhra Pradesh and Odisha are being interviewed with a semi structured questionnaire to understand the implementation difficulties of different inclusive policies. The choice of states is driven by different FIIND values i.e. 1 for Andhra and 7 for Odisha. The choices of districts in these two states are driven by relatively low credit deposit ratio with regard to all commercial banks.

In our visit to the rural branches of different banks in Jagatsinghpur district of Odisha, it is observed that the main credit portfolio of these branches is agriculture. However, some branches do have other business segments like home loan etc. but its share is very negligible. The other portfolios like pension, insurance is non-existent but branches are selling insurance guarantees to house loan customers as a combo product. The total credit portfolio of these branches is very low compared to the deposits. The main reasons of low credit off-take are lack of good quality loan proposal, and low repayment capacity of the customer. Most of the loans demanded by customers are only for consumption purposes. The NPA level is very high and is biggest concern for the officers in operations.

The case study of SBI TINY mobile remittances sketched a positive picture of inclusion which showed higher financial literacy, service specific quality of life and empowerment for users of

this service compared to a control group having similar demographic profile using any other cash management service. Lastly, the preference for informal sources by borrowers from villages and the factors behind the same was discussed based on a primary survey of 100 households from 2 villages of Rangareddy district of Andhra Pradesh. It was found that the rural population still prefers informal sources due to easy and timely available of credit.

5.3 Policy Suggestions

The following policy recommendations are made without any tall claims on findings from the current study. Having analyzed the secondary data and some primary evidence one finds that,

a) Credit is still inadequate as delivered by currently available formal sources and credit is on rigid terms that have affected the credit seeking behavior from formal sources.

b) Demand exists for services that require minimum documentation and provide for specific needs in terms of amount, repayment flexibility and timeliness of availability.

c) The ability to build formal credit history is an important factor and there should be a way to link this with efforts made to bring the excluded into the mainstream.

d) The field observations are also due to trust winning ability of informal sources even with existence of formal sources. The informal sources have been able to attract potential borrowers by luring them with easy, collateral free and timely credit.

e) An acceptable technology with low transaction cost like mobile based financial services seem to be transforming lives as evidenced in our SBI TINY case study. Hence attempts should be made to introduce technology that are less expensive for the user but socially and culturally acceptable.

f) Creating awareness about products that individuals think they do not need currently or are not demanding because of the lack of awareness about their benefits can play an important

role in impacting demand patterns for certain products such as pension and micro insurance products. Accordingly, the weightage of these products would change with change in demand affected by the increased levels of awareness. This change in demand may be a more suitable variable to measure than the current level of awareness, which is hard to quantify using household surveys.

g) There is a need to understand if usage can be linked with demand at all instances. For example, an urban slum client who is extremely individualistic might, only out of compulsion or lack of any other available product design, end up using the product that requires group collateral. The amount of the loan remains fixed and does not change with changing needs of the customer, leading to inadequate credit. Thus, exiting from the money lender option becomes even harder. This has implications for the existing product design processes.

h) Understanding individuals' hierarchy of credit needs is also important to find out what weightage would they give to various products and services.

To sum up the answer to the question "Has financial inclusion happened in India?" the study's answer would be "Yes to some extent" but lot more to be achieved in terms of correcting both formal and informal institutions and institutional practices. The experiments by both the Government and Non-government. have left a lot to build further, innovate and include the under privileged.

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Appendix-I

Financial Inclusion: Why Not Happened

Research project funded by Indian Institute of Banking and Finance

Principal Investigator: Debashis Acharya, Associate Professor, School of Economics

Co-Investigators: Tapas Kumar Parida, Economist, Corporate Group, SBI, Mumbai.

Respondent's Consent

Consent: We are doing a research survey on supply side constraints faced by senior/middle level managers on their efforts towards financial inclusion initiatives. We would like to ask you some questions to understand the supply side problems.

Your participation is entirely voluntary and this form will take about 1 hour. You can choose not to answer a question or stop the interview at any time. The information you share with us will be kept fully confidential and will be part of the report we will be submitting to IIBF. All interview recordings will be stored in a secure work space until 1 year after that date.

Will you answer our questions?

Yes……………….1 No………………..2 **TERMINATE**

1. What are the different financial inclusion initiatives implemented by your branch.
   Names of the schemes:
2. What is the total amount of credit disbursed under these schemes (with scheme wise break up)?
3. As per RBI data your branch falls under those having low credit deposit ratio and low disbursement branches. What is the reason behind this? What are the hindrances to mobilize deposits? What are the hindrances to advance credit in general and to low income groups in particular?
4. How many no frill accounts you have created as of today?
5. How many SHGs are financed by your branch?

6. How many SHGs have been advanced second or third loans? How is their repayment habit/performance? Do you follow fixed / flexible repayment schedule for them? Do you monitor their activities for which loan are sanctioned?
7. Have you approached SHGs to finance from your side but failed to advance loans under different schemes?
8. If so (yes to 7) what might be the reason? High interest rates/lack of ideas to utilize the loan/any other reason?
9. Do you have relationship officers to facilitate such loans like banks have sales team in urban areas for retail loans?
10. Have you taken up counseling potential customers for such activities? If no why?
11. Are there any other players in this area attracting such customers by providing credit?
12. Have you been asked to implement the Malegam committee recommendations? Has it been helpful in your FI initiative? Or it has created problems for you?
13. Do you think technology has a greater role in FI efforts?
14. Is current echnology not enough/appropriate for you at this moment for FI initiatives?
15. Do you think you are lagging because others are appropriating customers because of better technology?
16. Do you think the products floated from the head office aiming at FI are appropriate for the customers you face?
17. Do you think the compliance norms floated by the head office are simple to be implemented in all FI initiatives? Like complex documentation/collaterals/credit history etc.
18. Are you able to bundle other financial services like insurance/remittances along with your existing saving/loan products? If no what are the difficulties?
19. Is access a problem like distance from villages or fixed working hours to further FI initiatives?
20. Any other difficulties/observations you would like to share with us?

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