

REPORT
OF THE
COMMITTEE
ON
FINANCIAL INCLUSION

January 2008

Preface

Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. This has to become an integral part of our efforts to promote inclusive growth. In fact, providing access to finance is a form of empowerment of the vulnerable groups. Financial inclusion denotes delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. The various financial services include credit, savings, insurance and payments and remittance facilities. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty.

Extent of Exclusion

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 access 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 to 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.

Demand Side Factors

While financial inclusion can be substantially enhanced by improving the supply side or the delivery systems, it is also important to note that many regions, segments of the population and sub-sectors of the economy have a limited or weak demand for financial services. In order to improve their level of inclusion, demand side efforts need to be undertaken including improving human and physical resource endowments, enhancing productivity, mitigating risk and strengthening market linkages. However, the primary focus of the Committee has been on improving the delivery systems, both conventional and innovative.

National Mission on Financial Inclusion

The Committee feels that the task of financial inclusion must be taken up in a mission mode as a financial inclusion plan at the national level. A National Mission on Financial Inclusion (NaMFI) comprising representatives from all stakeholders may be constituted to aim at achieving universal financial inclusion within a specific time frame. The Mission should be responsible for suggesting the overall policy changes required for achieving the desired level of financial inclusion, and for supporting a range of stakeholders – in the domain of public, private and NGO sectors - in undertaking promotional initiatives.

A National Rural Financial Inclusion Plan (NRFIP) may be launched with a clear target to provide access to comprehensive financial services, including credit, to at least 50% of financially excluded households, say 55.77 million by 2012 through rural/semi-urban branches of Commercial Banks and Regional Rural Banks. The remaining households, with such shifts as may occur in the rural/urban population, have to be covered by 2015. Semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and

non-cultivator households per branch per annum, with an emphasis on financing marginal farmers and poor non-cultivator households.

Development and Technology Funds

There is a cost involved in this massive exercise of extending financial services to hitherto excluded segments of population. Such costs may come down over a period of time with the resultant business expansion. However, in the initial stages some funding support is required for promotional and developmental initiatives that will lead to better credit absorption capacity among the poor and vulnerable sections and for application of technology for facilitating the mandated levels of inclusion. The Committee has, therefore, proposed the constitution of two funds with NABARD – the Financial Inclusion Promotion & Development Fund and the Financial Inclusion Technology Fund with an initial corpus of Rs. 500 crore each to be contributed in equal proportion by GoI / RBI / NABARD. This recommendation has already been accepted by GoI.

Business Correspondent Model

Extending outreach on a scale envisaged under NRFIP would be possible only by leveraging technology to open up channels beyond branch network. Adoption of appropriate technology would enable the branches to go where the customer is present instead of the other way round. This, however, is in addition to extending traditional mode of banking by targeted branch expansion in identified districts. The Business Facilitator/Business Correspondent (BF/BC) models riding on appropriate technology can deliver this outreach and should form the core of the strategy for extending financial inclusion. The Committee has made some recommendations for relaxation of norms for expanding the coverage of BF/BC. Ultimately, banks should endeavour to have a BC touch point in each of the 6,00,000 villages in the country.

Procedural Changes

Procedural Changes like simplifying mortgage requirements, exemption from Stamp Duty for loans to small and marginal farmers and providing agricultural / business development services in the farm and non-farm sectors respectively, will help in extending financial inclusion.

Role of RRBs

RRBs, post-merger, represent a powerful instrument for financial inclusion. Their outreach vis-à-vis other scheduled commercial banks particularly in regions and across population groups facing the brunt of financial exclusion is impressive. RRBs account for 37% of total rural offices of all scheduled commercial banks and 91% of their workforce is posted in rural and semi-urban areas. They account for 31% of deposit accounts and 37% of loan accounts in rural areas. RRB's have a large presence in regions marked by financial exclusion of a high order. They account for 34% of all branches in North-Eastern, 30% in Eastern and 32% in Central regions. Out of the total 22.38 lakh SHGs credit linked by the banking industry as on 31st March 2006, 33% of the linkages were by RRBs which is quite impressive to say the least. Significantly the more backward the region the greater is the share of RRBs which is amply demonstrated by their 56% share in the North-Eastern, 48% in Central and 40% in Eastern region.

RRBs are, thus, the best suited vehicles to widen and deepen the process of financial inclusion. However, there has to be a firm reinforcement of the rural orientation of

these institutions with a specific mandate on financial inclusion. With this end in view, the Committee has recommended that the process of merger of RRBs should not proceed beyond the level of sponsor bank in each State. The Committee has also recommended the recapitalisation of RRBs with negative Net Worth and widening of their network to cover all unbanked villages in the districts where they are operating, either by opening a branch or through the BF/BC model in a time bound manner. Their area of operation may also be extended to cover the 87 districts, presently not covered by them.

SHG – Bank Linkage Scheme

The SHG - Bank Linkage Programme can be regarded as the most potent initiative since Independence for delivering financial services to the poor in a sustainable manner. The programme has been growing rapidly and the number of SHGs financed increased to 29.25 lakhs on 31 March 2007.

The spread of the SHG - Bank Linkage Programme in different regions has been uneven with Southern States accounting for the major chunk of credit linkage. Many States with high incidence of poverty have shown poor performance under the programme. NABARD has identified 13 States with large population of the poor, but exhibiting low performance in implementation of the programme. The ongoing efforts of NABARD to upscale the programme in the identified States need to be given a fresh impetus. The Committee has recommended that NABARD may open dedicated project offices in these 13 States for upscaling the SHG - Bank Linkage Programme. The State Govts. and NABARD may set aside specific funds out of the budgetary support and the Micro Finance Development and Equity Fund (MFDEF) respectively for the purpose of promoting SHGs in regions with high levels of exclusion. For the North-Eastern Region, there is a need to evolve SHG models suited to the local context of such areas.

NGOs have played a commendable role in promoting SHGs and linking them with banks. NGOs, being local initiators with their low resources, are finding it difficult to expand in other areas and regions. There is, therefore, a need to evolve an incentive package which should motivate these NGOs to diversify into other backward areas.

The SHG - Bank Linkage Programme is now more than 15 years old. There are a large number of SHGs in the country which are well established in their savings and credit operations. The members of such groups want to expand and diversify their activities with a view to attain economies of scale. Many of the groups are organising themselves into federations and other higher level structures. To achieve this effectively, resource centres can play a vital role. Federations of SHGs at village and taluk levels have certain advantages. Federations, if they emerge voluntarily from amongst SHGs, can be encouraged. However, the Committee feels that they cannot be entrusted with the financial intermediation function.

Extending SHG – Bank Linkage Scheme to Urban Areas

There are no clear estimates of the number of people in urban areas with no access to organized financial services. This may be attributed, in part at least, to the migratory nature of the urban poor, comprising mostly of migrants from the rural areas. Even money lenders often shy away from lending to urban poor. The Committee has recommended amendment to NABARD Act to enable it to provide micro finance services to the urban poor.

Joint Liability Groups

SHG-bank linkage has emerged as an effective credit delivery channel to the poor clients. However, there are segments within the poor such as share croppers/oral lessees/tenant farmers, whose loan requirements are much larger but who have no collaterals to fit into the traditional financing approaches of the banking system. To service such clients, Joint Liability Groups (JLGs), an upgradation of SHG model, could be an effective way. NABARD had piloted a project for formation and linking of JLGs during 2004-05 in 8 States of the country through 13 RRBs. Based on the encouraging response from the project, a scheme for financing JLGs of tenant farmers and oral lessees has also been evolved. The Committee has recommended that adoption of the JLGs concept could be another effective method for purveying credit to mid-segment clients such as small farmers, marginal farmers, tenant farmers, etc. and thereby reduce their dependence on informal sources of credit.

Micro Finance Institutions - NBFCs

Micro Finance Institutions (MFIs) could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele. The Committee has, therefore, recommended that greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but also eventually enable them to take and use savings as a low cost source for on-lending.

There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. Such MF-NBFCs may also be recognized as Business Correspondents of banks for providing only savings and remittance services and also act as micro insurance agents.

The Micro Financial Sector (Development and Regulation) Bill, 2007 has been introduced in Parliament in March 2007. The Committee feels that the Bill, when enacted, would help in promoting orderly growth of microfinance sector in India. The Committee feels that MFIs registered under Section 25 of Companies Act, 1956 can be brought under the purview of this Bill while cooperative societies can be taken out of the purview of the proposed Bill.

Revitalising the Cooperative System

Though the network of commercial banks and RRBs has spread rapidly and they now have nearly 50,000 rural/semi-urban branches, their reach in the countryside both in terms of the number of clients and accessibility to the small and marginal farmers and other poorer segments is far less than that of cooperatives. In terms of number of agricultural credit accounts, the Short Term Cooperative Credit System (STCCS) has 50% more accounts than the commercial banks and RRBs put together. On an average, there is one PACS for every 6 villages; these societies have a total membership of more than 120 million rural people making it one of the largest rural financial systems in the world. However, the health of a very large proportion of these rural credit cooperatives has deteriorated significantly.

For the revival of the STCCS, the Vaidyanathan Committee Report has suggested an implementable Action Plan with substantial financial assistance. The implementation of the Revival Package would result in the emergence of strong and robust cooperatives with conducive legal and institutional environment for it to prosper. A financially sound cooperative structure can do wonders for financial inclusion given its extensive outreach.

Micro Insurance

Micro-insurance is a key element in the financial services package for people at the bottom of the pyramid. The poor face more risks than the well off. It is becoming increasingly clear that micro-insurance needs a further push and guidance from the Regulator as well as the Government. The Committee concurs with the view that offering micro credit without micro-insurance is self-defeating. There is, therefore, a need to emphasise linking of micro credit with micro-insurance.

The country has moved on to a higher growth trajectory. To sustain and accelerate the growth momentum, we have to ensure increased participation of the economically weak segments of population in the process of economic growth. Financial inclusion of hitherto excluded segments of population is a critical part of this process of inclusion. We hope that the recommendations made in this Report, if implemented, will accelerate the process of financial inclusion.


C Rangarajan
Chairman

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List of Abbreviations

Ag/BDS	Agricultural and Business Development Services
AIRCS	All-India Rural Credit Survey
APMACS	Andhra Pradesh Mutually Aided Cooperative Societies
ASA	Association for Social Development
ATM	Automated Teller Machine
BBA	Basic Bank Account
BC	Business Correspondent
BDS	Business Development Service
BF	Business Facilitator
BI	Bank of Indonesia
BIRD	Bankers Institute of Rural Development
BISFA	Building Inclusive Financial Sector in Africa
BKD	Badan Kredit Desa
BPL	Below Poverty Line
BPR	Bank Perkreditan Rakyat
BRAC	Bangladesh Rural Advancement Committee
BRI	Bank Rakyat Indonesia
BSA	Basic Share Draft Account
CB	Commercial Bank
CDA	Cluster Development Association
CDF	Credit and Development Forum
CDMA	Code Division Multiple Access
CD-Ratio	Credit to Deposit Ratio
CGAP	Consultative Group to Assist the Poor
CEPS	Common Electronic Purse Specifications
CESS	Centre for Economic and Social Studies
CGFSI	Credit Guarantee Fund Scheme for Small Industries
CMRC	Community Managed Resource Centre
CPU	Central Processor Unit
CRAR	Capital to Risk-Weighted Assets Ratio
CSP	Customer Service Point
DCCB	District Central Cooperative Bank
DDM	District Development Manager
DLCC	District Level Consultative Committee
DNBS	Department of Non-Banking Supervision of RBI
ECS	Electronic Clearing System
EGS	Employment Guarantee Scheme
EMI	Equated Monthly Instalment
EMV	Electromagnetic Compatibility
FIC	Financial Inclusion Customer
FIPB	Foreign Investment Promotion Board
FSC	Farmers' Service Centre
GCC	General Credit Card
GoAP	Government of Andhra Pradesh
GoI	Government of India
GPRS	General Packet Radio Service
GSM	Global System for Mobile Communications

HR	Human Resources
ICAI	Institute of Chartered Accountants of India
IKP	Indira Kranthi Patham
IRDA	Insurance Regulatory and Development Authority
ISO-IEC	International Organisation for Standardisation - International Electrotechnical Commission
IT	Information Technology
JLG	Joint Liability Group
KCBP	Kalanjiam Community Banking Programme
KCC	Kisan Credit Card
KYC	Know Your Customer
LAB	Local Area Bank
LDKP	Lembaga Dana dan Kredit Pedesaan
LIC	Life Insurance Company of India
MACS	Mutually Aided Cooperative Societies
MDG	Millennium Development Goals
MFDEF	Micro Finance Development and Equity Fund
MFI	Microfinance Institution
MF-NBFC	Microfinance – Non-Banking Financial Company
MIS	Management Information System
MoRD	Ministry of Rural Development
MoU	Memorandum of Understanding
MRRU	Microfinance Research and Reference Unit
MS	Mandal Samakhyas
MW	Movement Worker
NABARD	National Bank for Agriculture and Rural Development
NAFSCOB	The National Federation of State Cooperative Banks
NBFC	Non-Banking Financial Company
NDDB	National Dairy Development Board
NDP	National Dairy Plan
NEFT	National Electronic Funds Transfer
NRFIP	National Rural Financial Inclusion Plan
NFC	Near Field Communication
NGO	Non-Government Organisation
NIBM	National Institute of Bank Management
NIRD	National Institute of Rural Development
NPA	Non Performing Assets
NSSO	National Sample Survey Organisation
NREGA	National Rural Employment Guarantee Act
NREGP	National Rural Employment Guarantee Programme
OBC	Other Backward Classes
ODI	Organisation Development Initiatives
OTS	One Time Settlement
PACS	Primary Agricultural Credit Society
PAIS	Personal Accident Insurance Scheme
PCARDB	Primary Cooperative Agriculture and Rural Development Bank
PFPP	Popular Finance Partnership
PKI	Public Key Infrastructure (for Digital Signatures)
POCA	Post Office Card Account
POS	Point of Sale

PRI	Panchayati Raj Institution
RFA	Revolving Fund Assistance (Related to SGSY)
RFI	Rural Financial Institution
RFID	Radio Frequency Identification
RIDF	Rural Infrastructure Development Fund of NABARD
PKSF	Palli Karma Sahayak Foundation
RPCD	Rural Planning and Credit Department of RBI
RTGS	Real Time Gross Settlement
RUDSETI	Rural Development and Self Employment Training Institute
SABA	South African Bank of Athens
SARFAESI Act	The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act
SBI	State Bank of India
SC	Scheduled Caste
SCARDB	State Cooperative Agriculture and Rural Development Bank
SCB	State Cooperative Bank
SERP	Society for Elimination of Rural Poverty
SGSY	Swarnajayanti Gram Swarojgar Yojana
SHG	Self-Help Group
SHPI	Self-Help Promotion Institution
SIMPUTER	Simple Computer or Simple Inexpensive Multi-lingual Computer
RKBY	Rashtriya Krishi Bima Yojana
SLBC	State Level Bankers' Committee
SLRFIP	State Level Rural Financial Inclusion Plan
SSI	Small-Scale Industries
ST	Scheduled Tribe
STCCS	Short-Term Cooperative Credit Structure
TFFI	Technology Fund for Financial Inclusion
UK	United Kingdom
UN	United Nations
UNCDF	UN Capital Development Fund
UN DESA	Department of Economic and Social Affairs of the UN
URN	Unique Relationship Number
USA	United States of America
UT	Union Territory
VO	Village Organisation

Executive Summary and Recommendations

Financial Inclusion – Defined

The recent developments in banking technology have transformed banking from the traditional brick-and-mortar infrastructure like staffed branches to a system supplemented by other channels like automated teller machines (ATM), credit/debit cards, internet banking, online money transfers, etc. The moot point, however, is that access to such technology is restricted only to certain segments of the society. Indeed, some trends, such as increasingly sophisticated customer segmentation technology – allowing, for example, more accurate targeting of sections of the market – have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle income population and a significantly large section of the population who lack access to even the most basic banking services. This is termed “financial exclusion”. These people, particularly, those living on low incomes, cannot access mainstream financial products such as bank accounts, credit, remittances and payment services, financial advisory services, insurance facilities, etc.

Deliberations on the subject of Financial Inclusion contributed to a consensus that merely having a bank account may not be a good indicator of financial inclusion. Further, indebtedness as quantified in the NSSO 59th round (2003) may not also be a reflective indicator. The ideal definition should look at people who want to access financial services but are denied the same. If genuine claimants for credit and financial services are denied the same, then that is a case of exclusion. As this aspect would raise the issue of credit worthiness or bankability, it is also necessary to dwell upon what could be done to make the claimants of institutional credit bankable or creditworthy. This would require re-engineering of existing financial products or delivery systems and making them more in tune with the expectations and absorptive capacity of the intended clientele. Based on the above consideration, a broad working definition of financial inclusion could be as under:

“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.”

The essence of financial inclusion is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, insurance (life and non-life), etc. While financial inclusion, in the narrow sense, may be achieved to some extent by offering any one of these services, the objective of “Comprehensive Financial Inclusion” would be to provide a holistic set of services encompassing all of the above.

With a view to understanding the extent of exclusion, the Committee perused data put out by various sources. The summary of conclusions is indicated below :

Extent of Exclusion – NSSO Survey 59th Round

(a) General :

- 51.4% of farmer households are financially excluded from both formal / informal sources.
- Of the total farmer households, only 27% access formal sources of credit; one third of this group also borrow from non-formal sources.
- Overall, 73% of farmer households have no access to formal sources of credit.

(b) Region-wise :

- Exclusion is most acute in Central, Eastern and North-Eastern regions – having a concentration of 64% of all financially excluded farmer households in the country.
- Overall indebtedness to formal sources of finance alone is only 19.66% in these three regions.

(c) Occupational Groups :

- Marginal farmer households constitute 66% of total farm households. Only 45% of these households are indebted to either formal or non formal sources of finance.
- About 20% of indebted marginal farmer households have access to formal sources of credit.
- Among non-cultivator households nearly 80% do not access credit from any source.

(d) Social Groups :

- Only 36% of ST farmer households are indebted (SCs and Other Backward Classes - OBC - 51%) mostly to informal sources.

Analysis of the data provided by RBI thru' its Basic Statistical Returns reveal that critical exclusion (in terms of credit) is manifest in 256 districts, spread across 17 States and 1 UT, with a credit gap of 95% and above. This is in respect of commercial banks and RRBs.

As per CMIE (March 2006), there are 11.56 crore land holdings. 5.91 crore KCCs have been issued as at the end of March 2006, which translated into a credit coverage of more than 51% of land holdings by formal sources. Further data with NABARD on the doubling of agricultural credit indicates that agricultural loan disbursements during 2006-07 covered 3.97 crore accounts.

Thus, there are different estimates of the extent of inclusion thru' formal sources, as the reference period of the data is not uniform. Consequently, this has had an impact on quantifying the extent of levels of exclusion.

Strategy for Building an Inclusive Financial Sector

1. Overall strategy for building an inclusive financial sector may be based on :

- Effecting improvements within the existing formal credit delivery mechanism;
- Suggesting measures for improving credit absorption capacity especially amongst marginal and sub marginal farmers and poor non-cultivator households;
- Evolving new models for effective outreach, and
- Leveraging on technology based solutions. (Para 3.01)

National Rural Financial Inclusion Plan (NRFIP)

2. Looking at the enormity of the task involved, financial inclusion must be taken up in a mission mode as a Financial Inclusion Plan at the national level. (3.03)

3. The target for NRFIP could be to provide access to comprehensive financial services to atleast 50% (55.77 million) of the excluded rural cultivator and non-cultivator households, across different States by 2012 thru' rural/ semi urban branches of CBs and RRBs. The remaining households, with such shifts as may occur in the rural/urban population, have to be covered by 2015. (3.03)

4. Semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and non-cultivator households per branch per annum, aggregating 11.15 mn. households p.a., with clear emphasis on financing marginal farmers, tenant cultivators and poor non-cultivator households. (3.04)

5. The national targets would have to be disaggregated State-wise with adequate focus on districts having a large percentage of population not accessing bank credit.(3.05)

6. Since per branch annual coverage under the Plan would be quite high in some of the North-Eastern, Eastern and Central States, needed support including financial assistance may be provided to banks operating in the above regions. (3.06)

7. To operationalise the NRFIP, DLCCs at district level shall draw up block-wise/village-wise maps of rural households not having access to formal credit sources. This information should be disseminated widely. District administration and Lead Banks will extend appropriate help to DLCC for completing the exercise in a time bound manner. This should to be dovetailed with the work being done by the monitoring mechanism set up at the district level for implementation of the recommendations of the CD Ratio Committee.

Thereafter, a State Level Rural Financial Inclusion Plan – SLRFIP shall be prepared jointly by the State Level Bankers' Committee (SLBC) and NABARD for arriving at a conclusive Financial Inclusion Plan for the State. With a minimum target coverage of 50% of currently excluded by the year 2012, States will be free to set for themselves higher targets. (3.07)

8. The Plan so prepared will thereafter be allocated institution-wise, among commercial banks and RRBs. Other institutions like cooperative banks, NBFCs, MFIs may also be asked to join in the task of financial inclusion with self-set targets. The progress in implementation shall be reported to and monitored at the DLCC.(3.08)

9. With a view to firming up the implementation of the recommendations of the Committee, it is proposed that GoI may consider constituting a National Mission on Financial Inclusion (NaMFI) comprising representatives of all stakeholders. The purpose of the Mission shall be to aim at achieving universal financial inclusion within a specific time frame. The Mission should be responsible for suggesting the overall policy changes required for achieving the desired level of financial inclusion, and for supporting a range of stakeholders – in the domain of public, private and NGO sectors - in undertaking promotional initiatives. Govt. may decide on appropriate representation from all stakeholders in the Mission. (3.09)

Commercial Banks

Specific recommendations for achieving the targets under NRFIP by leveraging the existing commercial bank branch network in rural areas would include the following :

Targets for rural / semi-urban branches

10. Given the existing staff strength, it should be possible for commercial banks (including RRBs) to provide access to credit to at least 250 hitherto excluded rural households at each of their existing rural and semi-urban branches. For this, banks will have to strengthen their staff and use a variety of delivery mechanisms. (4.18)

Targeted Branch Expansion in identified districts

11. In districts where population per rural and semi urban branch office is much higher than the national average, the DLCCs may identify centres for opening branches by commercial banks and RRBs in the next three years. (4.19)

12. For the North-Eastern Region, the Committee on Financial Sector Plan has already identified such centres and branch expansion plan as indicated therein may be implemented. (4.20)

Product Innovation

13. The excluded segments of the population require products which are customized, taking into consideration their varied needs. The products and services offered at present do not effectively meet these needs.

- (a) Savings : Savings products to meet the specific requirements of the poor need to be evolved. SHGs may be utilized for tapping the small savings by providing incentives to SHGs with suitable back-end technology support. Banks can develop medium and long term savings instruments by issue of pre-printed deposit receipts to SHGs which in turn can be sold to SHG members. Banks could be given the freedom to develop their own products, suited to local requirements and felt needs of the poor
- (b) Credit : A savings-linked financing model can be adopted for these segments. The approach should be kept simple which should guarantee the beneficiaries a credit limit, subject to adherence to simple terms and conditions. Credit within a specified limit can be made available in 2-3 tranches, with the second and subsequent tranches disbursed based on repayment behaviour of the first tranche. This is to ensure that the vulnerable groups do not get into a debt trap; it would also ensure good credit dispensation.
- (c) Insurance : Banks can play a vital role in this regard –by distributing suitable micro-insurance products. (4.21)

Incentivising Human Resource – Measurable performance indicators

14. Lending to low income groups and providing inclusive financial services need motivated bank staff. Such motivation is a function of attitudes and beliefs as also a system of incentives / disincentives put in place by the bank's management for special efforts / failures to achieve desired levels of financial inclusion. (4.22)

15. The existing staff posted to rural branches can be incentivised within a framework of performance parameters including covering of new households through deposit and loan accounts, increase in business in existing and new small loan / deposit accounts, increase in number of SHGs / Joint Liability Groups (JLGs) formed

and credit linked, efforts put in for promotion of asset management skills and developing linkages to promote credit absorption. (4.23)

Funding

16. There is a cost involved in providing credit plus services and adopting technology applications. Commercial banks are expected to meet a part of the costs. In the initial stages some funding support may be extended through specially constituted Funds. (4.24)

Financial Inclusion Funds

17. Two funds may be constituted – a Financial Inclusion Promotion & Development Fund, with NABARD, for meeting the cost of developmental and promotional interventions and a Financial Inclusion Technology Fund, with NABARD to meet the costs of technology adoption. Each Fund will have an initial corpus of Rs. 500 crore, with a start up funding of Rs. 250 crore each, to be contributed equally by GoI / RBI / NABARD and annual accretions thereto. Banks will be eligible for support from the Funds on a matching contribution of 50% from the Fund in regard to districts other than tribal districts and 75% in case of branches located in tribal districts identified under the Tribal Sub Plan. (4.25)

Financial Inclusion Promotion and Development Fund

The Financial Inclusion Promotion and Development Fund will focus on financing the following interventions :

Farmers' Service Centres (FSC) :

18. The Centres will network on the technology front with Agricultural Universities / KVVKs, farmers clubs, the formal extension machinery of the State Governments, technical staff of banks, portals of national level Commodity Exchanges, etc. Such FSCs can be financed by the banks on the pattern of agri clinics. In the initial stages, some support by way of viability gap funding may be provided.(4.26)

Promoting Rural Entrepreneurship :

19. Commercial banks may consider setting up institutions like farmer training centres and Rural Development and Self Employment Training Institutes (RUDSETI) for developing skills among farmers / rural entrepreneurs for effectively managing the assets financed. (4.27)

Self-Help Groups :

20. The SHG movement is yet to catch up on a big scale in regions manifesting high levels of exclusion (Central, Eastern and North-Eastern Regions). Funding support for promotion, nurturing and credit-linking of SHGs can be extended. (4.28)

Developing HR – Addressing attitudinal issues thru' training :

21. Lending to the poor raises, interalia, issues of attitudes towards the poor as viable and profitable customers. The Committee has observed that : (4.29)

There is a positive correlation between training received by the branch managers and their overall attitudes. (4.30)

The training module developed and tested for commercial banks and RRBs in the College of Agricultural Banking, Pune may be used / adopted by banks for bringing about the right mindset among branch staff. (4.31)

Resource Centres

22. Resource Centres, apart from facilitating members of mature SHGs to graduate to micro-enterprises, also helps in ensuring long term sustainability of SHGs. The cost of setting up such centers can be met out of this Fund and / or the MFDEF. This is discussed in detail later in the Report. (4.32)

Federations

23. As indicated later in the Report, funding support may also be extended from this Fund and / or MFDEF for voluntary establishment of federations. (4.33)

Capacity building of BFs/BCs

24. Funding support, on priority basis, to be extended to specialized institutions which provide capacity building inputs to BFs/BCs, as discussed later in the Report.(4.34)

Financial Inclusion Technology Fund

Technology Applications for Greater Financial Inclusion :

25. Extending outreach on a scale envisaged under NRFIP would require the application of low-cost technology solutions, which call for certain levels of funding support for rolling out such IT-based and inclusive financial sector plan. (4.35)

26. Funds Guidelines

NABARD, in consultation with RBI, may prepare detailed guidelines for operationalising the Funds. (4.36)

Procedural Changes

Simplifying Mortgage Requirements

27. Enabling legislation has been passed in some States for acceptance of a simple declaratory charge as equitable mortgage. This may be done by all the State Governments. (4.37)

Exemption from Stamp Duty for Loans to Small and Marginal Farmers:

28. Stamp duty may be waived in respect of loans for small / marginal farmers, tenant cultivators and oral lessees. (4.38)

Saral Documentation for Agricultural Loans

29. NABARD, in cooperation with a core group of bankers, has prepared a one page document for agricultural loans up to Rs.1 lakh. This may be adopted by all banks. (4.39)

Nodal Branches (ADB Model)

30. One branch of the lead bank at the block / taluka level may be identified as the nodal branch to address the issue of exclusion. Lead banks may strengthen these nodal branches with technical staff to provide agricultural / business development services in farm and non-farm sectors respectively, comprising technical inputs and extension

services. The services of the nodal branch technical staff may be made available to all other branches in the block, under an appropriate cost sharing arrangement. (4.40)

31. In some districts, where RRBs have dominant presence, sponsor banks may assist the RRBs in putting in place arrangements for technical staff for providing credit plus services. NABARD may defray the cost of such technical staff, particularly, in the North-Eastern Region. (4.41)

Business Facilitators / Business Correspondents (BFs/BCs)

32. RBI has permitted banks to use the services of NGOs / SHGs, MFIs and other civil society organisations as intermediaries in providing financial and banking services through the use of BF and BC Models. (4.42)

33. The response of the banking system has been of low key and the model is yet to be fully grounded. (4.48)

Following **recommendations** in respect of the BF/BC Model are made:

Business Facilitators (BFs)

34. Originally, only individuals who were insurance agents could act as BFs while no individuals could be placed as BC. This was later on widened to include retired officials, viz., Government servants like postmasters, school teachers and headmasters, who were considered by RBI as eligible to act as BF. Banks may make use of this relaxation and use individuals as indicated above as BF. (4.51)

35. Banks may appoint ex-servicemen/ retired bank staff as their BFs. (4.52)

36. Banks should ensure that the banking awareness created by BFs get converted to business potential by providing suitable banking services like mobile outlets. (4.53)

37. Banks may facilitate easy roll-out of this mobile banking model through simplification and rationalization of back-end processes and front-end procedures so that banking operations are made more customer-friendly. (4.54)

Business Correspondents (BCs)

38. In addition to the institutions presently allowed by RBI to function as BCs, individuals like locally settled retired Government servants like postmasters, school teachers, ex-servicemen and ex-bank staff, whose relationship with the banking system through a pension account has already been established, may be permitted to act as BCs. (4.56)

39. Further, MF-NBFCs may be allowed to act as limited BCs of banks for only providing savings and remittance services. (4.57)

40. Technology has to be an integral part in sustaining outreach efforts thru' the BC model. Ultimately, banks should endeavour to have a BC touch point in each of the six lakh villages in the country. (4.58)

41. In order to sustain and encourage the arrangements, banks may formulate suitable incentive mechanism for BCs linked to the number of accounts opened/ transactions put through by them. Further, banks may consider placing BCs even in areas having their own branches. (4.59)

42. To begin with, the BC model envisaged by RBI could be implemented widely. In due course, when the BCs reach a higher level of turnover, they should bear commensurate financial responsibilities. (4.60)

43. Banks may appoint any individual/institution of their choice as BCs, after exercising due diligence. This will facilitate greater acceptance of the BC Model by banks. (4.61)

44. Funds may be provided to specialized institutions which provide capacity building inputs to BCs. Such funding support could be extended on priority basis to most excluded areas/ sectors of the society. (4.62)

45. SLBC convener banks may initiate discussion with their respective State Governments regarding routing government payments through BCs using the smart card or other relevant technology on a pilot basis. (4.63)

46. SLBCs may undertake a study to identify organisations having the capacity to serve as customer service points and BC. In States like Andhra Pradesh and Kerala, the VOs and Kudumbashree structures already exist and these can be used as customer service points. (4.64)

47. Training modules for BFs/BCs may be prepared in vernacular and in culture sensitive pictorial forms. (4.65)

Role in microfinance

48. Deepening the outreach of the microfinance programme is an effective way in reaching out to the excluded segments. Commercial Banks have played a very important role in the SHG-Bank Linkage Programme having linked 15.95 lakh SHGs, forming more than 54% of the total SHGs credit-linked in the country. This programme should be strengthened and carried further, playing a key role in financial inclusion. (4.66)

Financing poor farmers

49. Joint Liability Groups (JLGs) of the poor such as landless, share croppers and tenant farmers is another innovative mechanism towards ensuring greater financial inclusion. Commercial Banks can actively promote such groups for effectively purveying credit and other facilities to such clients. RBI may encourage banks to adopt the JLG model for lending to SF/MF, tenant cultivators, share croppers and oral lessees. (4.67)

Making Marginal Farm Holdings Viable and Enabling their Financial Inclusion

50. The following recommendations are made :

- Government programmes aimed at enhancing agricultural productivity should be effectively linked with bank credit. (eg. Banking Plan in post-watershed projects).
- A massive programme for financing minor irrigation structures (wherever ground water levels are safe or where surface irrigation potential is available) may be undertaken specifically targeting marginal farm households.
- Supplementary activities like dairy, small poultry, sheep-rearing etc. have to be specifically targeted for marginal farmers, tenants and non-cultivator households. A National Dairy Plan (NDP) has been prepared to target production enhancement in 323 potential districts. Similar initiatives may be considered for other sectors also like poultry, horticulture, etc.
- Farm aggregation models including contract farming fully protecting the interests of farmers could be an option. Credit-marketing linkage can also be effected.(4.68)

Regional Rural Banks

Post-merger, RRBs, with 14494 branches, represent a powerful instrument for financial inclusion. Their role and relevance in financial inclusion is crucial as :

- In rural areas, they account for 37% of total offices of all Scheduled Commercial Banks.
- 91% of the total workforce in RRBs is posted in rural and semi-urban areas as compared to 38% for other Scheduled Commercial Banks.
- In rural areas, RRBs account for 31% of deposit accounts and 19% of deposit amount of all Scheduled Commercial Banks. Lower average deposit amount per account in RRBs as compared with commercial banks implies their better reach to small depositors.
- Share of RRBs in loan accounts is an impressive 37% in rural areas.
- Of all the scheduled commercial banks, RRBs account for 34% of branches in NE, 30% in Eastern and 32% in Central regions . Incidentally, these regions manifest financial exclusion of a high order.
- Of the total 29.25 lakh SHGs credit linked by the banking system (as on 31 March 2007), 31% linkage is done by RRBs. More significantly, the more backward a region, greater is the share of RRBs. In North Eastern Region, it is 56%, Central region 48% and Eastern region 40%.
- RRBs have also played a significant role as Self Help Promoting Institutions (SHPIs). As many as 104 RRBs (31 March 2006) are functioning as SHPIs with grant assistance from NABARD.

Keeping the above in view, the following recommendations are made for RRBs.

Recommendations

51. RRBs should extend their services to unbanked areas and increase their credit to deposit (CD) ratio. The post-merger scenario of RRBs poses a series of challenges for them and these are to be addressed. The following areas would require attention from the point of view of financial inclusion :

- Setting exclusive targets for microfinance and financial inclusion,
- Providing funding support &
- Providing technology support. (5.26)

No further merger of RRBs

52. Further merger of all RRBs at State-level across sponsor banks is not required. It may not also be desirable if there has to be a firm reinforcement of their rural orientation with a specific mandate on financial inclusion. Therefore, the process of merger should not proceed beyond the level of sponsor bank in each State. (5.27)

Recapitalisation of RRBs with negative Net Worth

53. Recapitalisation of RRBs with negative net worth has to be given a serious consideration as it would facilitate their growth, provide lenders a level of comfort and enable their achieving standard capital adequacy ratio. (5.28)

Widening network and Expanding coverage

54. As on 01 April 2007, RRBs are covering 535 districts. They may be directed to cover all unbanked areas in these districts, taking the village as a unit, either by opening a branch (wherever feasible) or through the BF / BC model in a time bound manner. 87 districts in the country were not covered by RRBs as on 01 April 2007 and their area of operation may be extended to cover these districts. (5.29)

Strategic microfinance plan with NABARD support

55. RRBs have the potential and capability to emerge as niche operators in microfinance. They are playing a major role in the SHG - Bank Linkage Programme especially also as SHPIs. Their dual role has special meaning in areas which face severe financial exclusion and which do not have a sufficient presence of well performing NGOs. However, to upscale the programme to a level where it can really make a visible impact, RRBs need handholding particularly in the areas of training, promotion and development. NABARD may provide required assistance. (5.30)

56. NABARD should prepare a strategic action plan RRB-wise, for promotion and credit linkage of SHGs. RRBs may be asked to form, nurture and credit link at least 3,000 SHGs in districts covered by them in North-Eastern, Eastern and Central Regions. A Memorandum of Understanding (MoU) may be signed by RRBs with NABARD for a period of 5 years - with NABARD providing the promotional and development assistance out of the "Financial Inclusion Promotion and Development Fund" and RRBs forming, nurturing and providing financial services to SHGs. RRBs may accomplish the task with the support of individual rural volunteers, BFs, their staff members, etc. NABARD may closely monitor the programme - with focus on qualitative aspects. (5.31)

NRFIP for RRBs

57. The strategy recommended for NRFIP for commercial banks would be equally applicable for RRBs. They would require promotional, funding and technology support in different areas as outlined below. RRBs may endeavour to cover a large part of their incremental lending through the group mode (SHGs/JLGs) as it will enhance their outreach to financially excluded. Lending through group mode would also keep NPAs at low level. (5.32)

Pilot testing of BF / BC Model by RRBs

58. RRBs should adopt the BF and BC models as a major strategy of financial inclusion. NABARD should extend the required support including running pilots in selected banks. The proposal for a technology based intervention under the BC model would be equally relevant for RRBs. However, RRBs would require some handholding in implementing the proposal. NABARD may identify 10 RRBs across the country, giving greater weightage to regions manifesting higher levels of financial exclusion and work in strategic alliance with these RRBs and their sponsor banks in implementing the proposal. The RRBs identified by NABARD for the project will require to develop a core banking software for proper integration of the technology model proposed. NABARD should enter into a MoU with identified sponsor banks and RRBs and provide initial funding and technology support. (5.33)

Separate credit plan for excluded regions

59. The RRBs operating in predominantly tribal areas and having high levels of exclusion may prepare annual credit plans having a separate component for excluded

groups, which would integrate credit provision with promotional assistance. Refinance and promotional support may be provided by NABARD to RRBs on a large scale for implementation of these credit plans. (5.34)

Computerisation

60. With a view to facilitating the seamless integration of RRBs with the main payments system, there is a need to provide computerisation support to them. Banks will be eligible for support from the Financial Inclusion Funds on a matching contribution of 50% in regard to districts other than tribal districts and 75% in case of branches located in tribal districts under the Tribal Sub Plan. (5.35)

Strengthening Boards of Management

61. Post-merger, it is necessary that Boards of Management of RRBs are strengthened and powers delegated to them on policy and business operations, viz. introduction of new liability and credit products, investment decisions, improving market orientation in raising and deployment of resources, non-fund based business, career progression, transfer policy, etc. (5.36)

Tax Incentives

62. From 2006-07, RRBs are liable to pay income tax. To further strengthen the RRBs, profits transferred to reserves could be exempted from tax till they achieve standard capital adequacy ratios. Alternately, RRBs may be allowed tax concessions to the extent of 40% of their profits, as per provisions under Section 36 (1)(viii) of the Income Tax Act. (5.37)

NABARD to support HR development in RRBs

63. NABARD may continue to give special priority to RRBs to train their staff through its training institutions. NABARD may design suitable training programmes to enable RRBs to meet the challenges in the post merger environment. This training may also cover members of the Board of RRBs. (5.38)

Implementation of RBI initiatives for financial inclusion

64. All the recent circulars relating to financial inclusion, viz., no frills accounts, GCC, One Time Settlement (OTS) for loans up to Rs. 25,000, use of intermediaries, etc., should be implemented by RRBs. (5.39)

Local Area Banks (LABs)

65. RBI may allow new LABs to come into operation, especially in districts / regions manifesting high levels of exclusion, without compromising on regulatory prescriptions. LABs can integrate well with local financial markets and offer a host of financial services including savings, credit, remittances, insurance, etc. (5.40)

Cooperative Credit Institutions

Rural credit cooperatives, in India, have a very long history. Democratic in features, the cooperative movement was envisaged as a mechanism for pooling the resources of people with small means and providing them with access to different financial services. In the backdrop of the reform process underway for cooperative banks, they have a very significant role to play in facilitating greater inclusion.

Recommendations

Early Implementation of Vaidyanathan Committee Revival Package

66. All necessary steps should be taken for the early implementation of the STCCS revival package in all States. (6.31)

Cooperatives in SHG-Bank Linkage – Need for enabling legislation

67. In certain States, legislation has been enacted, admitting SHGs as members of PACS. Similar legislation in other States would require to be enacted to enable the emergence of cooperatives as effective SHPIs. Federations of SHGs may be registered in all the States under the Cooperative Societies Act or the parallel Self Reliant Cooperatives Act and availability of funds to these cooperatives for advancing loans may be considered by NABARD, based on objective rating criteria. NABARD may also set aside requisite funds for sensitising the cooperative movement in this regard.(6.32)

Use of PACS and other Primary Cooperatives as Business Correspondents

68. There are a large number of PACS and primary cooperatives under the parallel Acts located in rural areas where there are no other financial services outlets. Many of these cooperatives are in districts where the DCCBs are defunct or moribund. Such PACS could provide valuable services to their members if they get access to a commercial bank. RBI has already listed Cooperatives as eligible institutions under the BF/BC Model. (6.33)

69. In the circumstances, Cooperatives may make use of this opportunity atleast in States which have accepted the Vaidyanathan Committee recommendations. NABARD may be asked to suggest appropriate guidelines for the purpose, subject to the approval of RBI. (6.34)

Cooperatives Adopting Group Approach for Financing Excluded Groups

70. Micro-enterprises, in order to be successful, require larger funding which NGOs cannot provide. It will, therefore, be necessary to develop / test a new form of community based organisation other than SHGs which may be more appropriate to support members who engage in micro-enterprises. Those members of SHG who opt to graduate to micro-enterprises could be formed into JLGs or some similar organisation. (6.35)

71. The relations of mutual trust and support which is described as affinity in a SHG tend to be weaker in a JLG. Therefore, new forms of collateral or guarantee may have to be worked out. Guidelines circulated by NABARD may be adopted by banks.(6.36)

72. Further, the use of the BF model could be thought of to organize vulnerable segments of the population into JLGs. The pilot project presently under implementation by NABARD should be sufficiently broad based to cover the role of facilitators in formation and linkage of JLGs. (6.37)

Risk Mitigation - setting up of Credit Guarantee Fund

73. A Credit Guarantee Fund may be set up as a risk mitigation mechanism and also for providing comfort to the banks for lending to such JLGs (akin to the Credit

Guarantee Fund Scheme of SIDBI for Small/ Micro enterprises Industries - CGFSI - available for small-scale industries - SSI - at present). (6.38)

Self Help Group – Bank Linkage Model

The SHG-Bank Linkage Programme is a major plank of the strategy for delivering financial services to the poor in a sustainable manner. As at the end of March 2007, as many as 29.25 lakh SHGs have been credit-linked with banks, benefiting more than 400 lakh poor families. There is a need for further deepening and upscaling of microfinance interventions.

Encouraging SHGs in Excluded Regions – Funding support

74. If the SHG-Bank Linkage programme has to reach a critical scale, the Department of Women and Child Development at State-level should be actively involved in promoting and nurturing of SHGs. The State Govts. and NABARD may, therefore, set aside specific funds out of budgetary support and the Micro Finance Development and Equity Fund (MFDEF) respectively for the purpose of promoting SHGs in regions with high levels of exclusion. (7.28)

75. The spread of SHGs in hilly regions, particularly in the North-Eastern Region, is poor. One of the reasons for this is the low population density in hilly areas and weak banking network. There is a need to evolve SHG models suited to the local context. (7.29)

Capacity building of Government functionaries

76. Certain deficiencies like poor follow up, ineffective monitoring and inadequate training and capacity building efforts have been observed in the past. Adequate safeguards may, therefore, be devised and built in future programme implementation strategies. NABARD can also facilitate this process by providing support for capacity building of Government functionaries from grass root level upwards within the SHG framework. (7.30)

Legal Status for SHGs

77. As of now, SHGs are operating as thrift and credit groups. They may, in future, evolve to a higher level of commercial enterprise. The question of providing a simplified legal status to the SHGs may have to be examined in full, in this context. This would also facilitate their becoming members of PACS. (7.31)

Maintenance of participatory character of SHG movement

78. A movement of such large scale involving people's participation could lead to attempts towards politicization. This must be avoided. Sufficient care has to be taken to ensure that the SHG movement retains its participatory and self-help character. (7.32)

NABARD to open 'Project Offices' in identified Priority States

79. NABARD is managing the MFDEF with a corpus of Rs. 200 crore. One major focus of the Fund should be promoting the SHG-Bank Linkage Programme in States where it has been comparatively slow moving. NABARD has already identified 13 States with large population of the poor, but exhibiting low performance in implementation of the programme. The ongoing efforts of NABARD to upscale the programme in the identified States need to be given a fresh impetus. (7.33)

80. NABARD can open dedicated project offices in the 13 States for upscaling the SHG - Bank Linkage Programme by strategizing interventions such as stronger involvement of State Governments, capacity building of NGOs, broadening the range of SHPI, etc. (7.34)

Incentive package for NGOs

81. Many of the NGOs have played a commendable role in promoting SHGs and linking them with banks. NGOs, being local initiators with their low resources are finding it difficult to expand in other areas and regions. There is, therefore, a need to evolve an incentive package which should motivate these NGOs to diversify into other backward areas. Incentive package could be in the form of expeditious and hassle-free grant support. (7.35)

RBI/NABARD to study the issue of 'evergreening'

82. A certain element of "evergreening" of loans is reportedly taking place among credit linked SHGs. This, if established, is a matter of concern. RBI/ NABARD may expeditiously study this aspect and come out with suggestions for reversing this unsettling trend. (7.36)

Transparency in maintenance of records

83. In order to ensure sustainability of the SHGs, their activities and linkages, there should be better transparency in the books of accounts maintained at the group level. These books should reflect the position of deposits in members' accounts, interest paid on savings, distribution of corpus or operating surplus among members, evergreening of loan accounts, etc. Banks, with the help of NABARD, should evolve a checklist for concurrent monitoring of SHGs. (7.37)

SHGs to evolve norms for distribution of surplus

84. Many of the SHGs do not have the practice of distributing the surplus generated from their business activities within the group and the awareness on this issue among the SHG members is very low. There is a need to evolve norms for distribution of surplus (akin to dividend) especially at the time when a member drops out of the group. (7.38)

Need to restructure design & direction of SGSY subsidy

85. Subsidies provided under SGSY need to be restructured. Linking credit with subsidy is not an effective approach for reaching out to the poor. There is a need to formulate a single programme synergising the positive features of SGSY such as specific targeting of Below Poverty Line (BPL) families, etc. and those of the SHG – Bank Linkage Programme such as group cohesiveness, discipline, etc. (7.39)

86. While recognizing that individual subsidies are distortionary, the Government may consider redirecting subsidy in the SGSY Programme for the following purposes:

- Capacity building of NGOs and other field based agencies such as Krishi Vigyan Kendras, to form and strengthen SHGs.
- Exposure visits to successful models by bankers, government officials and SHG leaders etc.
- For strengthening input supply and marketing arrangements. (7.40)

87. Some of the State Governments like West Bengal and Andhra Pradesh have initiated efforts in this direction. Further, it is understood that the proposals are awaiting approval of the GoI. The approaches adopted by these States for bringing synergy between SGSY groups and the SHGs of the linkage programme can be studied so that the same can be replicated in other States. The broad features of the proposed convergence model are indicated in Annexure V of the main report. (7.41)

88. The need for technology adoption for effective disbursement of Govt. subsidy should be recognized. The existing dispensation of subsidy under SGSY and payouts under NREGP could be routed thru' bank accounts, with suitable technology support.(7.42)

Interest rate subsidy

89. Certain States are reportedly providing a subsidy on interest rates being charged by banks to the SHGs. The margin available to SHGs is sufficient to take care of operational costs, even after considering the small amounts of loan provided to members. Thus, a subsidy on interest rates cuts at the very root of the self help character of SHGs. The subsidy could be re-directed towards capacity building efforts or in providing input supplies and marketing support to the SHGs. (7.43)

Resource Centres

90. For ensuring the long term sustainability of SHGs and for helping the members of mature SHGs to graduate from microfinance to micro-enterprises, Resource Centres on the lines of the Andhra Pradesh Mahila Abhivruddhi Society (APMAS) can be set up in different parts of the country. (7.44)

91. There are a large number of SHGs which are well established in their savings and credit operations. Their members want to expand and diversify their activities with a view to attain economies of scale. Many of the groups are organising themselves into federations and other higher level structures. To achieve this effectively, resource centres can play a vital role. (7.45)

92. Resource centres can be set up by various stakeholders such as NGOs, banks, Government departments, NABARD at the State/ district level to play an important role in preparing training modules, developing a cadre of trainers, conduct of field studies and in promoting interface between SHG members and service providers. The specific role of Resource Centres would be :

- To work towards a comprehensive capacity building of SHGs,
- Share innovative ideas and models that can be replicated elsewhere,
- Enhance functional literacy among SHG members,
- Support livelihood interventions among SHG members,
- Facilitate availability of all services to SHG members under one roof. (7.46)

93. The cost for setting up Resource Centres can be met out of the Financial Inclusion Fund and/ or the MFDEF. (7.47)

SHGs to provide alternative savings products

94. Most of the SHGs encourage compulsory savings with equal small amounts by members on a regular basis. SHGs need to offer a wide range of savings products so as to capture the huge potential of savings that remains untapped. Groups should be free to design savings products suiting to members' requirements. Certain level of

experimentation could be attempted by the Resource Centres in designing new saving products and NABARD should encourage and support such experiments. (7.48)

Adoption of JLG Model to cover marginalized groups

95. A scheme for financing JLGs of tenant farmers and oral lessees has been evolved by NABARD for implementation by all the commercial banks, RRBs and Cooperatives. The adoption of the concept of JLGs, if properly grounded, could be another effective method for purveying credit to mid-segment clients such as small farmers, marginal farmers, tenant farmers, etc. and thereby reduce their dependence on informal sources of credit. (7.49)

From Microcredit to Microenterprise - Challenges

96. The present challenge is to induce SHGs and their members to graduate into matured levels of enterprise, factor in livelihood diversification, increase their access to the supply chain, linkages to the capital market and appropriate production and processing technologies. (7.50)

97. A spin off of this challenge is how to address the investment capital requirements of matured SHGs, which have initially met members' consumption needs and are now on the threshold of taking off into "enterprise". There is evidence in MYRADA experience where lending for productive purposes has already been given greater emphasis by SHGs. The Community Managed Resource Centres (CMRCs) organized by MYRADA provide a variety of linkage services to SHGs and individual entrepreneurs among SHG members. This model requires to be studied. The SHG - Bank Linkage Programme needs to introspect whether it is sufficient for SHGs to only meet the financial needs of their members, or whether there is also a further obligation on their part to meet the non-financial requirements necessary for setting up business and enterprises. Ideally, it must meet both. (7.51)

Greater role for NABARD

98. While greater emphasis is needed for growth and spread of SHGs across the country, the quality in terms of outreach of financial services, capacity building, sustainability etc., needs to be reemphasized. NABARD shall play a pro-active role and identify new initiatives that will contribute to effectively improving outreach to the poor thru' SHGs, MFIs, etc. (7.52)

Federations

99. Federations, if they emerge voluntarily from amongst SHGs, can be encouraged. However, the Committee feels that they cannot be entrusted with the financial intermediation function.

In Andhra Pradesh, federations are registered as societies under the MACS Act. The SHG members (as individuals) are permitted to be members in the federation. In Uttarakhand, SHGs are permitted to become members of PACS directly. Other States may adopt similar enabling legislation. (7.53 & 7.54)

100. Voluntary establishment of federations could be supported out of the Financial Inclusion Fund and the MFDEF. While extending support, it should be ensured that :

- Federations emerge voluntarily, on the felt need of the SHGs,
- Federations provide other value added services to member SHGs. Based on a study of Federations operating across the country, a broad list of such services and

the modus operandi of federations in providing such services can be prepared and circulated by NABARD.

- Federations, in terms of distance, operate in close proximity to members. (7.55)

Urban Microfinance

101. There are no clear estimates of the number of people in urban areas with no access to organized financial services. This may be attributed, in part at least, to the migratory nature of the urban poor, comprising mostly of migrants from the rural areas. Even money lenders often shy away from lending to urban poor. (7.56)

102. There have been a few instances of MFIs venturing into this area of lending to urban poor who are undertaking micro-enterprises and small business activities. Urban branches of banks, even though having manpower and technology support, are not attuned to SHG lending or microfinance. (7.57)

103. Opening of specialised microfinance branches / cells in potential urban centers exclusively catering for microfinance and SHG - bank linkages could be thought of, to address the requirements of the urban poor. BF / BCs could be the mechanism to reach the target clientele in these areas. Banks can also consider associating with MFIs undertaking urban microlending as a viable option. (7.58)

Amendment to NABARD Act

104. At present, NABARD is permitted, as per its Act and Mandate, to support micro finance activities in rural and semi-urban areas only. An enabling provision be made in the NABARD Act, 1981 permitting NABARD to provide micro finance services to the urban poor. (7.59)

Micro Finance Institutions

Introduction

105. Firm data regarding the number of MFIs operating under different forms is not available. However, it is roughly estimated that there are about 1,000 NGO-MFIs and more than 20 Company MFIs. Further, in Andhra Pradesh, nearly 30,000 cooperative organizations are engaged in mF activities. However, the company MFIs are major players accounting for over 80% of the micro finance loan portfolio. (8.02)

Definition of MFI

106. The proposed Microfinance Services Regulation Bill defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for an amount, not exceeding rupees fifty thousand in aggregate (Rs.1,50,000 if for housing purposes) (8.03)

107. Greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but could eventually enable MFIs to take and use savings as a low cost source for on-lending. (8.05)

Recognising MF-NBFCs

108. There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could be defined as companies that provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. (8.07)

109. At least 80% of the assets of MF-NBFCs should be in the form of microcredit of upto Rs.50,000 for agriculture, allied and non farm activities and in case of housing, loans upto Rs. 1,50,000/- per individual borrower, whether given through a group mechanism or directly. (8.08)

MF-NBFCs as BCs

110. To enable the poor to have access to savings services, MF-NBFCs may be recognized as Business Correspondents of banks for only providing savings and remittance services. (8.09)

Relaxation in FIPB guidelines

111. Current guidelines used by FIPB (Foreign Investment Promotion Board) require a minimum of US\$ 500,000 equity investment from a foreign entity. MF-NBFCs' initial capital needs may not be very large and the Committee is of the view that the minimum amount of foreign equity for MF-NBFCs may be reduced to a level of US\$ 100,000/-. (8.10)

112. NABARD may extend equity support out of its MFDEF to such MF-NBFCs based on objective rating / criteria. NABARD may accord priority in providing equity support to those MF-NBFCs operating in regions featuring high levels of exclusio(8.11)

113. The SEBI Venture Capital Guidelines may permit Venture Capital Funds to invest in MF-NBFCs. (8.12)

Tax Concessions

114. MF-NBFCs may be allowed tax concessions to the extent of 40% of their profits, as a proportion to their business portfolio in excluded districts as identified by NABARD without attracting tax. For this, MF-NBFCs may be included as eligible institutions under Section 36(1) (viii) of the Income Tax Act. (8.13)

MF-NBFCs as microinsurance agents

115. The IRDA Microinsurance Guidelines, 2005 may permit MF-NBFCs to offer microinsurance services as agents of regulated life and non-life insurance companies.(8.14)

Code of conduct

116. A voluntary mutual code of conduct, already prepared, covering aspects including mission, governance, transparency, interest rates, handling of customer grievances, staff conduct, recovery practices, etc., may be made mandatory for MFIs.(8.15)

Accounting and Disclosure Norms

117. The Institute of Chartered Accountants of India (ICAI) may be involved in formulating appropriate accounting and disclosure norms for MFIs. (8.16)

118. Banks lending to MFIs may undertake studies on the cost of funds of MFIs, risk premium, etc. and exercise a lender's discipline in enforcing reasonable rates of interest and acceptable modes of recovery. (8.17)

Unifying regulatory oversight

119. RBI may consider bringing all regulatory aspects of microfinance under a single mechanism. Further, supervision of MF-NBFCs could be delegated to NABARD by RBI. (8.18)

Micro Finance Bill

120. While Section 25 Companies could be covered by the Micro Financial Sector (Development and Regulation) Bill, 2007, cooperatives can be taken out of the purview of the proposed Bill. (8.19)

Technology Applications

Technology – The Driving Force for Low-cost Inclusion Initiatives

121. Technological developments in the recent past have provided the perfect launch pad for extending banking outposts to remote locations without having to open bank branches. This could be achieved by leveraging technology to open up channels beyond branch network and create the required banking footprints to reach the unbanked so as to extend banking services similar to those dispensed from branches.(9.01)

122. The Committee, while concurring with the RBI's advisory group for IT-enabled financial inclusion, is of the view that nearly all pilot models converge on certain essential components and processes to be followed in technology application. The essence of a majority of the models under consideration features the issue of a smart card to the farmer on which all his transactions are recorded, a hand-held terminal with the BC at the village level and a Central Processor Unit (CPU) linking the smart cards and BC terminals with the banks. There are also other models where smart cards are dispensed with and mobile telephones, etc., are used. (9.02 / 9.03)

123. The fundamental outlines of the existing technology-based models may be examined for application in such manner and to such extent as may be deemed fit.(9.04)

124. The operating costs of the various models are expected to be minimal and can be easily absorbed by banks as the increase in business volumes will justify the incremental operating costs. Also, the costs are substantially lowered if the infrastructure is shared. It is, therefore, recommended that shared infrastructure among different banks enabling nationwide financial inclusion would confer large scale benefits and also enable effortless transfer of funds between the card holders of various banks. (9.06)

125. Essentially, the start up costs are the initial investment costs comprising cost of the smart card, terminals with the BC and the CPU. The Committee is of the view that the Financial Inclusion Technology Fund can provide the necessary support for defraying part of the costs. (9.07)

Optimisation of Existing Infrastructure

126. The Committee is of the opinion that the existing banking infra-structure and NGOs which have already made extensive inroads in rural areas should be made optimal use of for enabling outreach of banking services. The BF/BC models backed by technology applications should encourage a role for the small players and integrate them with the national system. The Committee is of the opinion that the State

Governments should make payments under National Rural Employment Guarantee Scheme and Social Security Payments thru' such technology based solutions. (9.09)

Building database

127. The creation of a national data-base, sectoral, geographic and demographic reports, and also a payment system benefiting the card holders from the under-privileged/ unbanked population will not be possible without the extensive use of IT. This alone can bring down the costs of the small ticket transactions of the poor and make nationwide financial inclusion a reality. (9.10)

128. The technology suppliers and banks should evolve common minimum standards for ensuring inter-operability between their systems. (9.11)

Remittance Needs of Poor

129. Ahmednagar DCCB has implemented a system of low cost anywhere banking solution which has a facility of card to card transfer. Savings / current account holders at all its 280 branches have a choice to keep their savings bank account or a part thereof in a separate account at the bank's head office. Customers can have access to this account from all the bank branches. It was learnt that the customer is charged only Rs.4 per transaction. Such experiments may be studied for replication. (10.09)

130. A low value card linked to a bank account, which can be encashed at PoS and which allow transfer of small amounts from one card to another would alleviate remittance problems. This would substantially increase banking outreach as at present there are about 3 lakh PoS as compared to around 70,000 scheduled commercial bank branches and 22,000 ATMs. However, a majority of PoS machines are now located in urban and semi-urban areas. It is expected that as the system takes roots, more PoS will come in rural areas, facilitating such transfers. (10.10)

131. The e-kiosks in villages could be yet another source of operating a remittance system that is accessible to the poor. (10.11)

Other Recommendations

132. The following suggestions would substantially address the remittance needs of the poor in the country :

- i. The combined network of nearly 70000 branches of scheduled commercial banks (including RRBs) and a network of more than 1.50 lakh post offices can ideally provide the institutional mechanism for extending remittance facilities in remote areas. With adoption of appropriate technology, it may be possible to bring down the transaction costs which would encourage and enable the poor to make use of such remittance facilities. A committee may be set up with representatives from RBI, Department of Posts, NABARD and commercial banks for exploring the feasibility of integrating postal network with the banking system and developing a nation wide remittance system.
- ii. The remittance product could be an electronic product similar to "Instacash" where a 16 digit code is given to the originator of the transaction, and the beneficiary can take the amount from select post offices by giving the code, and identity proof. This product should be available across banks, post offices and other institutions and be affordable. Another option could be to credit the remitted amount to a central server at the originating point and at every touch point should be able to withdraw it.

- iii. Banks should endeavour to have a BC touch point in each of the six lakh villages in the country. There should be a micro-bank in every village.
- iv. Banks should introduce card-based remittance products which can be encashed all over the country. This may be card to card transfer, or simply a scratch card type remittance card. (10.14)

Micro Insurance

133. Micro-insurance should provide greater economic and psychological security to the poor as it reduces exposure to multiple risks and cushions the impact of a disaster. Micro-insurance in conjunction with micro savings and micro credit could go a long way in keeping this segment away from the poverty trap and would truly be an integral component of financial inclusion. (11.02)

134. In 2003, GoI constituted a Consultative Group on Micro-Insurance to examine existing insurance schemes for rural and urban poor. The report of the consultative group has brought out the following key issues :

- Micro-insurance is not viable as a standalone insurance product.
- Micro-insurance has not penetrated rural markets. Traditional insurers have not made much headway in bringing micro-insurance products to the rural poor. (In addition, the Committee feels that micro insurance has not penetrated even among the urban poor).
- Partnership between an insurer and a social organisation like NGO would be desirable to promote micro-insurance by drawing on their mutual strengths.
- Design of micro-insurance products must have the features of simplicity, availability, affordability, accessibility and flexibility. (11.04)

135. The Committee studied four different models for delivering micro-insurance services to the targeted clientele, viz., the Partner-Agent Model, Full Service Model, Community Based Model and Provider Model. (11.11)

Recommendations

Leveraging the Existing Network for Micro-Insurance

136. To economise on costs and to increase the outreach of micro-insurance to the poor, the insurers need to utilize existing Government organisations and NGOs, having greater acceptability among the financially excluded. The partner-agent model for delivery where the insurer underwrites the risk and the distribution is handled by an existing intermediary, seems apt in this scenario. (11.12)

Linking micro credit with micro insurance

137. The Committee concurs with the view that offering microcredit without micro-insurance is financial behaviour fraught with risk. There is, therefore, a need to emphasise linking of microcredit with micro-insurance. (11.13)

Further, as it helps in bringing down the inherent risk cost of lending, the Committee feels that NABARD should be regularly involved in issues relating to rural and micro insurance to leverage on its experience of being a catalyst in the field of micro-credit.(11.14)

Implementation Strategy for Micro-Insurance

138. The Committee has identified major areas for formulation of strategies for effective implementation of micro-insurance programmes as explained in the following paragraphs : (11.15)

Human Resources Requirement and Training

139. To tap the huge micro-insurance potential, IRDA may consider putting in place an appropriate institutional structure for deciding on service packages including premia and formulating strategies for effective promotion of micro-insurance. There is also a felt need for development, of both full-time and part-time staff, thru' effective training in insurance marketing and servicing concepts. (11.16)

Operations and Systems

140. To address the requirements of the huge market potential available, appropriate systems should be evolved for tracking client information, either manually or using technology. While a technology platform may take time for setting up, in the long-run, the same will be cost-effective and reliable. Similarly, the procedures for claims, premium payments / renewals and other services should be formalized along with increased customization of products to stimulate demand.(11.17)

Development of Adequate Feedback Mechanism

141. Keeping in view the diverse nature of market requirements, suitable mechanisms to collect market intelligence, collating and interpretation of the same in a formally structured manner, is important for product development and process refinement. (11.18)

Development of Data Base

142. High costs of penetration and acquisition often leads to higher pricing of products, thereby impacting client outreach and market depth. Building up historical data base on risk profiles, claims, settlement ratios, etc., will facilitate in better pricing of products, based on actual rather than presumed risks. Besides enabling cost reduction, warehousing of such data will make the market more transparent for entry of more operators. (11.19)

Consumer Education, Marketing and Grievance Handling

143. The micro-insurance sector is unique in the sense that there is an ongoing challenge to explain the concept and benefits to the insured. Creating awareness thru' use of pictorial posters, local folk arts and street theatres might be useful to explain the mechanisms of insurance. Local community-based organisations could organize premium collections, as they have better access to the local people. To make it more acceptable to the people, micro-insurance products, apart from covering only risks, should also provide an opportunity for long term savings (endowment). (11.20)

Product Development / Process Re-engineering

144. Customised product development to suit the varying requirements of the local populace is a pre-requisite. The processes / procedures are to be streamlined and simplified, to facilitate easier access for the rural poor. Information should be made available in vernacular for easy understanding of the terms on offer. (11.28)

Using Existing Infrastructure

145. Micro-insurance service providers can use the existing banking infrastructure and also adopt the agency-mode (NGOs, SHGs, NBFCs, etc.) for providing services, thereby leveraging on the existing physical branch network and reducing costs. (11.30)

Use of Technology

146. The technology platforms being envisioned to facilitate financial inclusion should enable micro-insurance transactions also. Towards this end, there is a need to integrate the various modules - savings, credit, insurance, etc. - into the technology framework so that holistic inclusive efforts are possible in the rural areas. (11.31)

Review of existing schemes

147. There are a large number of group life and health insurance schemes which are run by various central ministries and State Governments. The level of actual coverage in terms of claims preferred and settled in such schemes is disturbingly low. These schemes should be reviewed by an expert group set up by the IRDA. (11.32)

Life Insurance:

148. A wide range of products are available but penetration is really limited in rural areas. The procedural requirements at the time of entry and in case of claims settlement are cumbersome. The commission structure for agents is also heavily weighed in favour of getting new policies with very little incentive to service existing policies. In this regard, Micro Insurance Guidelines (MIG) 2005 issued by IRDA has provided for equal commission throughout the life of a policy and this will now remove the disincentive in servicing existing policy holders. (11.34)

Health Insurance:

149. In case of Health Insurance, penetration level is even much lower than Life Insurance. The two categories viz., Critical Illness and Hospitalisation are the main product segments. Some State Governments have developed Health Insurance schemes which are still in very early stages.

150. The Committee has observed that the mutual health insurance models have advantages of its members performing a number of roles such as awareness creation, marketing, enrolment, premium collection, claims processing, monitoring, etc. Under this arrangement, the costs of offering small-ticket health insurance gets significantly reduced. The high co-variant risks such as epidemics will have to be taken care of by a mutual entity taking re-insurance for such risks.

151. IRDA has also suggested that the capital requirements for stand-alone health insurance companies be reduced to Rs.50 crore as against Rs.100 crore for Life Insurance Companies and the Committee endorses the same. (11.35)

Crop Insurance:

152. This is a very important risk mitigation arrangement for small and marginal farmers. However, leaving the discretion to notify crops/regions to state governments has contributed to adverse selection. Further, claims settlement based on yield estimation has been cumbersome and the sampling area for crop cutting experiments is very large. An alternative model based on weather insurance has been attempted. To make it more effective, there is a need for having a large number of smaller

weather stations. The Committee recommends that policies be evolved to make crop insurance universal, viz., applicable to all crops/regions and pricing actuarial. (11.36)

Livestock Insurance:

153. As in Life Insurance, the problem lies in the process of enrolment and claims settlement. Several pilots indicate that the involvement of local organisations like SHGs, dairy co-operatives, NGOs and MFIs improves the quality of service, reduces false claims and expedites claims settlement. The Committee recommends that these experiences be studied and adopted by insurance companies. (11.37)

Asset Insurance:

154. This could cover a wide range including residential buildings, farm and non-farm equipments and vehicles. The main constraint seems to be lack of distribution channels appropriate for lower income groups. The Committee again recommends that involving local NGOs, MFIs, SHGs, etc. as distribution channels as well as facilitators of claims settlements would be quite useful. (11.38)

Demand Side Causes And Solutions for Financial Inclusion

The Committee's Report has so far concentrated on supply side issues of financial inclusion and what can be done to enhance supply of financial services, through increased outreach by existing institutions, enhancing their incentives to serve the excluded and adding new distribution channels. The Committee is of the view that financial exclusion is also caused by demand side issues. Unless some initiatives are taken on the demand side, or in the "real sectors", mere supply side solutions from the financial sector will not work. (12.01)

Recommendations

Human Development

155. Regions, segments and sectors financially excluded require substantial investments in human development. In particular, primary health, nutrition, primary education and vocational training need attention. The Twelfth Finance Commission had already taken a lead in this direction by earmarking additional funds for health and education in backward States. The Committee is of the view that this will lead to enhanced economic efficiency and consequent demand for financial inclusion, within a few years. (12.15)

Access to Land and Titling

156. The Committee is supportive of various Government programmes under which surplus land is distributed to landless and marginal farmers. The Committee has also noted that the Government has enacted recently The Forest Dwellers and Tribal Land Rights Act, 2006, which will ensure that those who had been cultivating a piece of land for decades in the middle of forests, will now get security of tenure. This will open up the possibility of their accessing credit from banks. (12.16)

157. The Committee has noted and endorses the recent move by NABARD to provide refinance for credit extended by banks and co-operatives to oral lessees and tenant farmers. This category of farmers has long been financially excluded due to lack of land titling or recorded tenures. Procedural changes in banks must be brought about to extend credit outreach to all such productive farmers. (12.17)

158. Banks hesitate to finance tenant farmers / oral lessees as they do not have documentary proof of their right to till the land for raising crops or for investment purposes. Recording of tenancy and ownership rights on land is an important measure to enable access to credit. (12.18)

159. Certificates by revenue officers or a system of land cultivation certificate by the Village Panchayats or local bodies may be made acceptable as documentary proof for cultivating the land. (12.19)

160. Computerisation of land records will lead to systematization of land records and overall availability of required information to banks facilitating their loan appraisal process. It is observed that 12 States have already initiated the process and GoI may advise all States to give priority for completing this process within a year. This will reduce cost to farmers in obtaining various documents and recording encumbrance. (12.20)

Access to Work – NREGA

161. Given the fact that nearly 80% of farmer households in the country are small and marginal farmers, who rarely have work on their own farms for more than 100 days a year, the availability of wage employment in the vicinity of their villages is critical. In this context the Committee noted the nation-wide roll-out plans supported by the National Rural Employment Guarantee Act (NREGA) which ensures that every household in need can ask for paid wage work for upto 100 days per year.(12.21)

162. The Committee endorses the creative use of the NREGP payments thru' bank accounts to enhance financial inclusion, as practiced in Andhra Pradesh. In Andhra Pradesh, the beneficiaries / depositors will be issued smart cards to enable transactions at several locations besides the bank branch. (12.22)

Infrastructure Support

163. The Committee noted the significant progress made for rural connectivity through the Pradhan Mantri Gram Sadak Yojana and the attempt to extend electric power to unconnected villages through the Rajiv Gandhi Gram Vidyutikaran Yojana. In several states the RIDF managed by NABARD has enabled the creation of much needed roads, bridges, irrigation canals, water harvesting structures and other useful infrastructure. The Committee endorses this and recommends a further impetus in the area. (12.23)

164. The National Development Council (NDC) has recommended that the normative allocation of RIDF funds among States should be decided by factoring in, *inter alia*, the CD ratio as a relevant criterion. This should be attempted by NABARD to improve equitable distribution of RIDF resources. (12.24)

Enhancing Productivity and Incomes

Productivity Enhancement

165. In this connection, the Committee has already recommended the establishment of Nodal Branches in each block to undertake intensive efforts for agricultural and business development services to farm and non-farm sector borrowers respectively. The Committee also recommends that banks explore tie-ups with government extension agencies, Krishi Vigyan Kendras, reputed NGOs working in

this field, agri-business clinics and corporates engaged in agricultural activities, to provide inputs, extension services and market linkages to the bank's borrowers so as to offer credit plus services and enhance the efficiency of credit. (12.26)

Value Addition – Primary processing

166. The Committee recommends that efforts should be made to ensure that all agricultural produce is subjected to primary and if possible secondary value addition locally. This means that post-harvest drying, sorting, grading and packing, can be done at the village level, preferably by women's SHGs. Farmers groups can come together to establish secondary value addition facilities such as groundnut shelling, cotton ginning, dal milling, rice hulling, fruit pulping, milk chilling, etc. (12.27)

Alternate Market Linkages

167. Roads, transport, power and water provide critical linkages in support of production-based activities. Social services like health, education, etc. contribute to improvements in the quality of rural life. State Governments should prioritise infrastructure planning, use of funds of the National Rural Employment Guarantee Programme (NREGP) for building critical infrastructure and encourage community participation in creation and maintenance of assets. (12.28)

Reducing Vulnerability

Risk Mitigation through Non-financial Channels

168. A vast majority of poorer households in India are exposed to high levels of risk and considered as not insurable at reasonable levels of premium. Their risk levels need to be mitigated through soil and water conservation measures, watershed development, installing protective irrigation and by using appropriate agronomic practices all the way from ploughing techniques to seed selection and timely farm operations. In the case of livestock rearers, risks can be reduced by proper herd management practices and mass vaccination for example against foot and mouth disease. It is only after this type of investments have reduced the risks in farming that the private expense in buying insurance can be affordable. (12.29)

Calamity Relief Fund

169. Repeated natural calamities and consequent rescheduling of bank loans take the debt burden beyond the repaying capacity of farmers. There is a need for the creation of a National Calamity Fund to address the problems of farmers in distress districts. Further, the subsidy on crop insurance may be directed more effectively towards the disadvantaged sectors. (12.30)

Managing Price Risks through Warehouse Receipts and Commodity Derivatives

170. Apart from the physical risks which impact crop yields, farmers also suffer from price risks. In bumper years, their harvest fetches low prices. In order to hedge against such price risks the right instrument is commodity derivatives, particularly futures options in which a farmer can be assured of selling his produce at a certain price in future. (12.31)

171. The Committee also noted that the Indian farmer is highly attuned to dealing in spot markets, traditionally known as Mandis, where the commodity is exchanged for cash. The Committee therefore supports any initiatives towards improving the transactional efficiency of spot markets. (12.32)

172. The Committee noted that several multi-commodity exchanges have come up in the last few years and that they are registering a large turn over. This enables farmers to discover the future price and take decisions related to crop selection. The Committee is supportive of such initiatives. (12.33)

173. However, the Committee noted the fact that a vast majority of financially excluded farmers have only a small marketable surplus and thus cannot benefit from the vibrant commodity exchanges, where the minimum traded lot is much larger than what the individual farmer has to offer. In order to extend the benefits of derivative exchanges to excluded farmers, aggregation mechanisms such as cooperatives need to come up. (12.34)

174. In the interim, financial instruments such as warehouse receipts and post-harvest credit can be offered so that farmers can avoid distress sales. The passage of the Warehousing (Development and Regulation) Bill, 2005 by Parliament is likely to open up a number of avenues for farmers to mitigate their price risks by encashing stock pledged in a warehouse to meet their cash needs, while waiting for the right price. The Committee is supportive of efforts to establish a chain of authorized warehouses throughout rural India, to provide such services, particularly when such warehouses are linked to PACS. (12.35)

Organising the Unorganised producers

175. In order for financial inclusion efforts to be sustainable, banks need to aggregate credit demand from the small borrowers. The celebrated mechanism for this is the SHG of which there are now more than 2.9 million in India linked with banks. (12.36)

176. Another well known mechanism for collective action is commodity cooperatives. There is no better example than the dairy producers cooperative societies established by the NDDDB. (12.37)

177. The Committee recommends the establishment of similar commodity cooperatives to cover a large number of small and marginal producers all over the country. The effort for bringing the producers together can be undertaken by specialized agencies like NDDDB and suitable NGOs, while the cost for this should be defrayed by either the Government or by the banks, or a combination thereof. (12.38)

178. The Financial Inclusion Fund cannot be used for a better purpose than supporting a competent and committed agency to organise commodity producer cooperatives in areas such as large cardamom in Sikkim, lac in tribal areas of Eastern Madhya Pradesh, Tasar in Northern Jharkand and seaweed in coastal Andhra Pradesh.(12.39)

179. The Committee endorses Government programmes such as *Velugu programme* in Andhra Pradesh, which promote organizing the unorganized producers, and recognizes that this cannot happen without the social intermediate of competent and committed NGOs. The legitimate expenses of such intermerdiaries need to be met.

Initially, banks can lend to groups based on considerations of viability; but this will eventually lead to individual lending as individual producers grow. This is the slow and steady process that the Committee recommends to build true financial inclusion.(12.41)

Chapter - 1

Introduction and Overview

1.01 A well functioning financial system empowers individuals, facilitates better integration with the economy, actively contributes to development and affords protection against economic shocks. Inclusive finance - through secure savings, appropriately priced credit and insurance products, and payment services - helps vulnerable groups such as low income groups, weaker sections, etc., to increase incomes, acquire capital, manage risk and work their way out of poverty.

1.02 Notwithstanding the efforts made so far, a sizeable majority of the population, particularly vulnerable groups, continue to remain excluded from the opportunities and services provided by the financial sector. With a view to correct this situation and extend the reach of the financial sector to such groups by minimising the barriers to access as encountered by them, the Government of India (GoI) vide order no. 6/5/2006/AC dated 22 June 2006 constituted a “Committee on Financial Inclusion” as under :

Chairman :

Dr C Rangarajan, Chairman, Economic Advisory Council to the Prime Minister.

Members :

Shri Vinod Rai, Secretary (Financial Sector), Ministry of Finance, GoI.

Shri R Bandyopadhyay, Additional Secretary, Ministry of Telecommunications, GoI.

Shri M B N Rao, Chairman & Managing Director, Canara Bank.

Shri Yogesh Agarwal, Chairman & Managing Director, IDBI.

Prof Mahendra Dev, Director, Centre for Economic and Social Studies (CESS), Hyderabad.

Shri Vijay Mahajan, Chairman, BASIX, Hyderabad.

Shri R Gopalakrishnan, Executive Director, TATA Sons, Mumbai.

Shri A P Fernandez, Executive Director, MYRADA, Bangalore.

Member Secretary :

Dr Y S P Thorat, Chairman, National Bank for Agriculture and Rural Development (NABARD).

Permanent Invitee :

Smt Usha Thorat, Deputy Governor, Reserve Bank of India (RBI).

Terms of Reference

1.03 The Terms of Reference assigned to the Committee were :

- To study the pattern of exclusion from access to financial services disaggregated by region, gender and occupational structure.

- To identify the barriers confronted by vulnerable groups in accessing credit and financial services, including supply, demand and institutional constraints.
- To review the international experience in implementing policies for financial inclusion and examine their relevance / applicability to India.
- To suggest :
 - ❖ a strategy to extend financial services to small and marginal farmers and other vulnerable groups, including measures to streamline and simplify procedures, reduce transaction costs and make the operations transparent;
 - ❖ measures including institutional changes to be undertaken by the financial sector to implement the proposed strategy of financial inclusion;
 - ❖ a monitoring mechanism to assess the quality and quantum of financial inclusion including indicators for assessing progress.

Approach of the Committee

1.04 The Committee is of the view that while financial inclusion can be substantially enhanced by improving the supply side or the delivery systems, it is also important to note that many regions, segments of the population and sub-sectors of the economy have a limited or weak demand for financial services. In order to improve their level of inclusion, demand side efforts need to be taken including improving human and physical resource endowments, enhancing productivity, mitigating risk and strengthening market linkages. However, the primary focus is on improving the delivery systems, both conventional and innovative.

1.05 With a view to set their recommendations within a broad/ empirical framework, the Committee analysed the data presented by the NSSO (National Sample Survey Organisation) Survey (59th round) supplementing it with information on credit flow from RBI / NABARD. The NSSO Survey covers 51,770 rural households spread over 6,638 villages and deals with indebtedness among farmer households according to source or purpose of loan and their distribution over different social and economic parameters such as social groups, sources of income, size-class of land possessed, etc. in different States/ Union Territories (UT). An indebted household is defined by the NSSO Survey as one which had any loan in cash or kind from formal and informal sources, provided its value at the time of transaction was Rs. 300 or more. However, the emerging conclusions could be different if the definitional aspect relating to Rs.300 undergoes a change.

Structure of the Report

1.06 The Report has been set out in thirteen Chapters. Chapter II deals with the definition of financial inclusion and draws conclusions on the basis of the data presented in the NSSO Survey (59th round). Chapter III recommends the adoption of a National Rural Financial Inclusion Plan (NRFIP) to approach the challenge of financial inclusion on a Mission Mode. Chapter IV to VI deal with the constituents of the multi-agency approach, their strengths and weaknesses and make suggestions for facilitating better credit flow for inclusive growth within the extant framework and by adopting the Business Facilitator (BF) / Business Correspondent (BC) Models. Chapters VII and VIII deal with issues relating to the Self-help Group (SHG) - Bank Linkage Programme and MFIs. Chapter IX outlines the scope for application of technology for cost effective models of BFs / BCs. Remittance mechanism for greater financial inclusion forms Chapter X while issues concerning micro-insurance are

addressed in Chapter XI. The demand side perspectives are covered in Chapter XII. Key learnings from international experiences are featured in Chapter XIII. In Chapter XIV concluding observations are made.

1.07 The Committee held eleven meetings between July 2006 and November 2007. Keeping in view the broad Terms of Reference, the Committee sought the advice of experts having domain knowledge in various fields. The experts consulted included bankers, IT specialists, insurers, micro finance professionals and NGOs. Insurance Regulatory and Development Authority (IRDA) as well as Institute for Development and Research in Banking Technology (IDRBT) provided useful inputs. The Committee is grateful to all these experts for their advice and support.

1.08 The Chairman and Member Secretary held separate discussions with members of Self Help Groups, private corporates, Government officials, bankers, IT corporates, MFIs, etc., during the course of their field-visits as part of the Committee's work. Representatives from the private corporate sector also made presentations before the members on their initiatives in reaching out to the rural poor through innovative delivery mechanisms.

1.09 Smt. Usha Thorat, Deputy Governor, Reserve Bank of India was associated with the Committee as a permanent invitee. She actively participated in the deliberations of the Committee and the Committee wishes to record its appreciation of her contributions particularly in matters relating to commercial banks, RRBs and technology induction.

1.10 The Committee wishes to place on record the contributions and inputs provided to it by Dr K G Karmakar, Managing Director, NABARD.

1.11 Officials of the RBI provided useful inputs to the Committee at various stages while the College of Agricultural Banking shared the findings of studies conducted by them. The Committee is further grateful to the Reserve Bank of India for making available to it the services of Dr Pradeep Maria, Director, DESACS, New Delhi and Dr (Smt.) Praggya Das, Asst. Adviser, DESACS, Mumbai. They assisted the Committee by collating, organising and analysing the voluminous statistical data. Various commercial banks also undertook special studies to field-test several ideas. The Committee is grateful to all of them for their assistance.

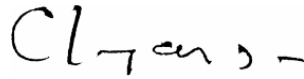
1.12 NABARD set up a separate Secretariat to assist the Committee. While thanking all the members, the Committee would like to make special mention of the contributions made by Shri R. Krishnamurthy, Chief General Manager & Secretary and Shri Manikumar S, Manager. Besides taking care of logistical and operational aspects, they facilitated the work of the Committee by analyzing the inputs received from various sources and preparing the first draft of the various chapters.

Dr V Puhazhendhi, GM, Department of Economic Analysis and Research (DEAR), Dr R N Kulkarni, Executive Assistant to Dr Thorat (Member Secretary) and Shri Ashok Misra, AGM, NABARD were actively associated with the Committee's work, at various stages. Their efforts and inputs are thankfully acknowledged. The Committee also wishes to thank all staff members of NABARD, who have helped the Committee.

Both the New Delhi and Andhra Pradesh Regional Offices of NABARD had played a very significant part in organizing the meetings of the Committee. The Centre for Economic and Social Studies (CESS), Hyderabad had hosted the meetings of the

Committee on quite a few occasions. The Committee recognizes the importance of these efforts and sincerely thanks the officials involved.

1.13 The Committee also wishes to place on record the contributions made by persons not specifically mentioned here, but who have given their counsel to the Committee on various occasions. The Committee is grateful to them for their efforts.



C Rangarajan

Chairman



Vinod Rai

Member




R Bandyopadhyay

Member



Yogesh Agarwal

Member



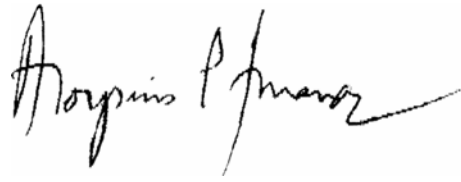
M B N Rao

Member



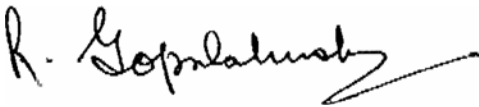
Vijay Mahajan

Member



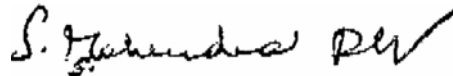
A P Fernandez

Member



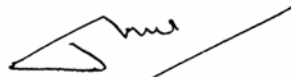
R Gopalakrishnan

Member



Mahendra Dev

Member



Y S P Thorat

Member Secretary

Chapter – 2

Nature and Extent of Exclusion

Background

2.01 Access to finance, especially by the poor and vulnerable groups is a pre-requisite for employment, economic growth, poverty reduction and social cohesion. Further, access to finance will empower the vulnerable groups by giving them an opportunity to have a bank account, to save and invest, to insure their homes or to partake of credit, thereby facilitating them to break the chain of poverty.

2.02 The banking industry in India has recognized this imperative and has undergone certain fundamental changes over the last two decades. Reforms since the early nineties in the banking sector have facilitated increasing competition, the development of new generation private sector banks as well as technological breakthrough in diverse financial products, services and delivery channels. With the recent developments in technology, both delivery channels and access to financial services have transformed banking from the traditional brick-and-mortar infrastructure like staffed branches to a system supplemented by other channels like automated teller machines (ATM), credit / debit cards, internet banking, online money transfer, etc.

2.03 The moot point, however, is that access to such technology is restricted only to certain segments of the society. Indeed, some trends, such as increasingly sophisticated customer segmentation technology – allowing, for example, more accurate targeting of sections of the market – have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle income population and a significantly large section of the population who lack access to even the most basic banking services. This is termed “financial exclusion”. These people, particularly, those living on low incomes, cannot access mainstream financial products such as bank accounts, low cost credit, remittances and payment services, financial advisory services, insurance facilities, etc.

2.04 In its landmark research work titled “Building Inclusive Financial Sectors for Development”¹ (2006), more popularly known as the Blue Book, the United Nations (UN) had raised the basic question : “why are so many bankable people unbanked?” An inclusive financial sector, the Blue Book says, would provide access to credit for all “bankable” people and firms, to insurance for all insurable people and firms and to savings and payments services for everyone.

2.05 “Financial inclusion, thus, has become an issue of worldwide concern, relevant equally in economies of the under-developed, developing and developed nations. Building an inclusive financial sector has gained growing global recognition bringing to the fore the need for development strategies that touch all lives, instead of a select few.”²

¹ & ² The book is a result of a project undertaken by the UN Department of Economic and Social Affairs (DESA) and the UN Capital Development Fund (UNCDF) to analyse the obstacles to financial inclusion and to report on efforts to overcome those obstacles in various countries.

2.06 Experience has shown that in the initial phase of real and financial sector reforms, there is a need to build in adequate provisions ensuring that the economically weak segment of population have increased participation in the process of economic growth and social development. Reforms in financial systems, therefore, need to be complemented by measures that encourage the institutions, instruments, relationships and financing arrangements to be properly geared for providing sound, responsive financial services to the majority of the people who do not have such access.

Who Needs to be Included?

2.07 The essence of financial inclusion is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, etc.

2.08 “However, inclusive finance does not require that everyone who is eligible uses each of these services, but they should be able to choose to use them, if they so desired. To this end, strategies for building inclusive financial sectors have to be creative, flexible, appropriate to the national situation and if necessary, nationally owned.”³

2.09 For promoting financial inclusion, we have to address the issue of exclusion – of people who desire the use of financial services, but are denied access to the same. In countries with a large rural population like India, financial exclusion has a geographic dimension as well. Inaccessibility, distances and lack of proper infrastructure hinder financial inclusion. Vast majorities of population living in rural areas of the country have serious issues in accessing formal financial services.

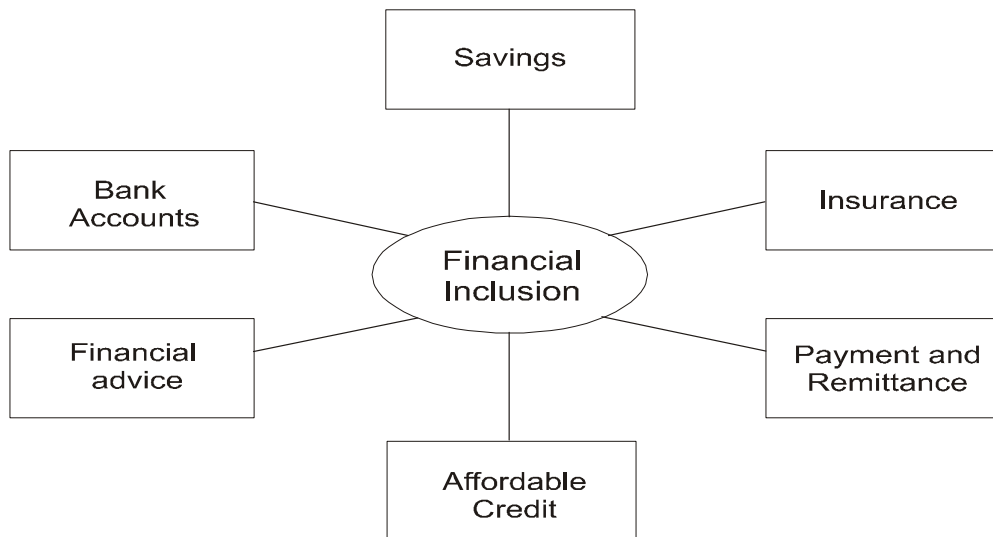
2.10 Another facet of exclusion which needs to be addressed is “Social Exclusion” – which is an extreme consequence of what happens when people do not get a fair deal throughout their lives, often because of disadvantages they face at birth, and this can be transmitted from one generation to the next. Social exclusion is about more than income poverty. It is a short-hand term for what can happen when people or areas have a combination of problems such as unemployment, discrimination, poor skills, low incomes and poor housing. These problems are linked and mutually reinforcing.

Financial Inclusion - Defined

2.11 By financial inclusion, we mean delivery of banking services and credit at an affordable cost to the vast sections of disadvantaged and low income groups. The various financial services include savings, loans, insurance, payments, remittance facilities and financial counseling / advisory services by the formal financial system. An open and efficient society is always characterized by the unrestrained access to public goods and services. As banking services are in the nature of public goods, financial inclusion should therefore be viewed as availability of banking and payment services to the entire population without discrimination of any type.

³ The Blue Book - Chapter 1 : Setting the stage for building inclusive financial sectors, pp3.

FINANCIAL INCLUSION



2.12 However, the term financial inclusion is perceived in different ways under different contexts. There is a view that only access to credit is treated as financial inclusion whereas the other view includes all the services extended by the financial institutions. That apart, financial inclusion by banks and other institutions must target, apart from personal / private investment requirements of individuals and groups, the universal public investment requirements necessary for development of infrastructure, social sector services, public utilities and productive forces / capacity building efforts, etc. Thus, financial inclusion may well be all about money and finance, but with the ultimate objective of directly abolishing the state of social exclusion in the economy.

2.13 The Committee, on several occasions, deliberated at length the need for arriving at a working definition of the term “Financial Inclusion”. In these deliberations, a consensus emerged that merely having a bank account may not be a good indicator of financial inclusion. Further, indebtedness as quantified in the NSSO, may also not be a fully reflective indicator. Hence, the ideal definition should look at people who want credit, but are denied the same. However, the Committee also appreciated the fact that bankers cannot be advised to extend credit to everyone who approached them. If genuine claimants for credit are denied, then there is a case of exclusion. Therefore, it naturally means that all cases of denial of credit may not be exclusion. Further, the fact of denial of credit should be probed further. As this aspect raises the issue of creditworthiness or bankability, the Committee also deliberated on what could be done to make the “institutionally excluded”, bankable or creditworthy. The Committee was also concerned with the issue regarding the denial of credit by formal sources for no fault of the credit applicant and what is needed to address such a situation? This may require re-engineering of existing financial products or delivery systems and making them more in line with the expectations of the intended clientele.

2.14 The segregation between institutional and non-institutional sources of credit was recognised, as indebtedness to the moneylender cannot be a sign of financial inclusion. Rather it has to be seen as a sign of exclusion as a major part of this segment would have been denied access to institutional credit.

2.15 The Committee felt the need for a normative definition – one, which would look into the issues, related to people desiring access to credit, but denied the same. Other issues may be a spin-off from this basic premise. A broader definition could also be considered; one, which would take care of issues not only, related to savings and credit, but also insurance and financial advisory services.

2.16 Viewed from the angle of indebtedness, nearly 49% of the farmer households in the country were indebted – of which, 27% to formal sources and 22% to informal sources. Can this be interpreted to mean that this 22% were in need of bank credit, but denied? Of the remaining 51% of farm households who are not indebted at all, 78% were small and marginal farmers who would, definitely, welcome access to credit on reasonable terms. Only the remaining segment may not require any form of external support.

2.17 The Committee also considered the segment of the population “once included”, but has since gone out of the system either due to default or other reasons. The Committee held the view that this aspect formed a part of the sub-set of those who got credit at some time in the past, but were denied the same, later on. The number of defaulted loan accounts could be taken as a proxy to translate this aspect into a quantifiable indicator.

Financial Inclusion - Working Definition

2.18 Based on the above discussions, the following working definition of “Financial Inclusion” was considered by the 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.

Holding a bank account itself confers a sense of identity, status and empowerment and provides access to the national payment system. Therefore, having a bank account becomes a very important aspect of financial inclusion. Further, financial inclusion, apart from opening and providing easy access to a No Frills account, should also provide access to credit, perhaps in the form of a General Credit Card (GCC) or limited OD against the no frills account. It should encompass access to affordable insurance and remittance facilities. It should also include credit counseling and financial education / literacy. While financial inclusion, in the narrow sense, may be achieved to some extent by offering any one of these services, the objective of “comprehensive financial inclusion” would be to provide a holistic set of services encompassing all of the above.

NSSO Survey Results

2.19 The Committee debated the various dimensions of inclusion and concluded that while aspects such as savings, remittance facilities, insurance, etc. were important, nevertheless exclusion was particularly germane from the standpoint of access to credit by vulnerable groups. The Committee accordingly scanned the data put out by the NSSO in the situation assessment survey on “Indebtedness of Farmer Households” (2003). The Committee noted that the definition of indebtedness as adopted in the survey referred to farmer households having outstanding loans from

institutional or non-institutional sources⁴ in cash or kind having a value of Rs.300 or more at the time of transaction.

2.20 As per NSSO data, 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). In other words, 73% of farm households do not have access to formal credit sources. For purposes of this analysis, “financially excluded” households will be defined as those not having any debt to formal credit sources. The various aspects of such exclusion among specific regions and population groups are indicated below.

Level of Non-indebtedness : Across Regions

2.21 The farm households not accessing credit from formal sources as a proportion to total farm households is especially high at 95.91%, 81.26% and 77.59% in the North Eastern, Eastern and Central Regions respectively. In terms of absolute numbers these regions taken together account for 64% of farm households not accessing credit from formal sources as detailed below :

No. of Farmer Households (HH) in Lakh

Region	Total HHs	Indebted HHs	% to total HHs	Non indebted HHs	% to total HHs	Indebted to formal sources	% to total HHs	Excluded by formal sources	% to total HHs
Northern	109.46	56.26	51.40	53.2	48.60	27.423	25.05	82.04	74.95
North Eastern	35.40	7.04	19.90	28.36	80.10	1.448	4.09	33.95	95.91
Eastern	210.61	84.22	40.00	126.39	60.00	39.467	18.74	171.14	81.26
Central	271.33	113.04	41.60	158.29	58.40	60.814	22.41	210.52	77.59
Western	103.66	55.74	53.70	47.92	46.30	45.586	43.98	58.07	56.02
Southern	161.56	117.45	72.70	44.11	27.30	69.072	42.75	92.49	57.25
Group of UTs	1.48	0.49	33.10	0.99	66.90	0.15	10.14	1.33	89.86
All India	893.50	434.24	48.60	459.26	51.40	243.96	27.30	649.54	72.70
NE, C & E Regions *	517.34	204.30	39.49	313.04	60.51	101.73	19.66	415.61	80.34
Share to All-India (%)	57.90	47.05		68.16		41.70		63.99	

* NE = North-Eastern Region, C = Central Region, E = Eastern Region.

2.22 The Southern Region, on the other end, exhibits relatively better levels of access to formal / non-formal sources (72.7%) mainly on account of spread of banking habits and a more robust infrastructure.

Level of Non-indebtedness : Across States

2.23 The proportion of non-indebted farmer households was most pronounced in Jammu & Kashmir (68.2%) and Himachal Pradesh (66.6%) in the Northern Region,

⁴ Institutional sources include Government, cooperative societies and banks, while non-institutional sources include agricultural / professional money lenders, traders, relatives and friends, doctors, lawyers and other professionals etc.

all States in the North-Eastern Region (61.2% to 95.9%) except Tripura, in Bihar (67%) and Jharkhand (79.1%) in Eastern Region, and Chhatisgarh (59.8%), Uttar Pradesh (59.7%) and Uttaranchal (92.8%) in the Central Region, as per details given below :

State / Region	Non-indebted farmer HHs @		State / Region	Non-indebted farmer HHs @	
	Lakh	%		Lakh	%
Northern	53.21	48.7	West Bengal	34.53	49.9
Haryana	9.11	46.9	Central	158.29	58.4
Himachal Pradesh	6.03	66.6	Chhatisgarh	16.50	59.8
Jammu & Kashmir	6.43	68.2	Madhya Pradesh	31.09	49.2
Punjab	6.38	34.6	Uttar Pradesh	102.38	59.7
Rajasthan	25.26	47.6	Uttaranchal	8.32	92.8
North Eastern	28.36	80.4	Western	47.92	46.3
Arunachal Pradesh	1.15	94.1	Gujarat	18.20	48.1
Assam	20.51	81.9	Maharashtra	29.72	45.2
Manipur	1.61	75.2	Southern	44.11	27.3
Meghalaya	2.44	95.9	Andhra Pradesh	10.84	18.0
Mizoram	0.60	76.4	Karnataka	15.52	38.4
Nagaland	0.51	63.5	Kerala	7.82	35.6
Tripura	1.19	50.8	Tamil Nadu	9.93	25.5
Sikkim	0.36	61.2			
Eastern	126.39	60.0	Group of UTs	0.99	66.9
Bihar	47.42	67.0			
Jharkhand	22.34	79.1	All India	459.26	51.4
Orissa	22.09	52.2	@ refers to non-indebtedness to both formal / non-formal sources		

Level of Indebtedness to Institutional Sources

2.24 Derived data indicate that only 27.3% of the total farm households were indebted to institutional sources as detailed below :

Region	Total no. of HHs (lakh)	Incidence of indebtedness to both formal and non formal sources		Indebtedness to institutional sources	
		Lakh HHs	(% to total HHs)	Lakh HHs	(% to total HHs)
Northern	109.46	56.26	51.39	27.42	25.05
North Eastern	35.40	7.04	19.88	1.45	4.09
Eastern	210.61	84.22	40.01	39.47	18.74
Central	271.33	113.04	41.66	60.81	22.41
Western	103.66	55.74	53.77	45.59	43.98
Southern	161.56	117.45	72.70	69.07	42.75
Group of UTs	1.48	0.49	33.10	0.150	10.14
All India	893.50	434.24	48.60	243.96	27.30

2.25 Data disaggregated by States indicate that indebtedness among the more “inclusive states” also exhibit high recourse to non-institutional sources of finance. In the States of the Southern Region this is particularly the case in Andhra Pradesh and Tamil Nadu. The State-wise levels of exclusion from formal sources are provided later in the Report.

Level of Non-indebtedness : Across Marginal / Small Farmer Households

2.26 It can be seen from the table below that 87% of all non-indebted farm households belong to the marginal (70.6%) and small (17.1%) farmer categories. The NSSO estimates of the year 2003 show that only around 45% of marginal farmer households (viz., up to 1 ha.) had access to both institutional and non-institutional credit. There are no data to show the position of finance extended exclusively to marginal farmers by institutional sources. A major portion of the credit from financial institutions for weaker sections has supported small farmers. However, marginal farmers who account for 66% of all farm holdings remain by and large excluded from the formal financial system and by rough approximation, only around 20% of these households access credit from formal banking sources.

Category of farmer HH	Size class of land owned (Ha)	Total farmer HHs (no. lakh)	Non-indebted farmer HHs (no. lakh)	Incidence of exclusion by both formal and non formal sources (%)	Proportion of non-indebted HHs. (%)
Marginal	<1.00	589.06	324.04	55.0	70.6
Small	1.01 – 2.00	160.60	78.68	49.0	17.1
Semi-medium	2.01 – 4.00	93.50	39.10	41.8	8.5
Medium	4.01 – 10.00	42.58	14.84	34.9	3.2
Large	10.00 +	7.76	2.60	33.6	0.6
All sizes		893.50	459.26	51.4	100.0

2.27 It is discernible that the proportion and level of inability to access credit increases with the decline in size of farm holdings.

Level of Non-indebtedness : Across Social Groups

2.28 The highest levels of non-indebtedness to both formal and non-formal sources is observed among Scheduled Tribes (ST) with 63.7%, followed by Scheduled Castes (SC) with 49.8% as detailed below :

Households	Sched-uled Tribes	Sche-duled Castes	Other Backward Classes	Others	All
Total no. of farmer HHs (lakh)	119.24	155.93	370.43	247.90	893.50
Non-indebted farmer HHs (lakh)	75.94	77.60	179.96	125.76	459.26
Proportion of non-indebted farmer HHs (%)	63.69	49.77	48.58	50.73	51.40

2.29 Incidence of financial exclusion among all non-cultivator households was estimated at 78.2% which comprises of 78.8% of agricultural labourer households, 71.4% of artisans and 79.7% of other rural households. Out of 5.96 crore non-cultivator households about 4.66 crore were estimated to be financially excluded. The number of non-cultivator households affected by financial exclusion was the highest for ‘others’ category (2.44 crore), followed by agricultural labourer households (1.67 crore) and artisans (0.55 crore) as detailed below :

Households	Agricultural labourers	Artisans	Others	Total non-cultivators*
Number of households (crore)	2.12	0.77	3.06	5.96
Number of households facing financial exclusion (crore)	1.67	0.55	2.44	4.66
Incidence of financial exclusion(%)	78.80	71.40	79.70	78.20

* Agricultural labourers, artisans, others (as per National Classification of Occupations, 1968)

Data based on AIDIS Report on Household Indebtedness in India (59th round), NSSO.

Scheduled Commercial Banks 2005 – Credit Gap – District Level Estimate

2.30 According to Basic Statistical Returns of Scheduled Commercial Banks 2005 (including RRBs), there were 77 million credit accounts and 467 million deposit accounts. Of the credit accounts, 98% were extended to individuals (including partnership, proprietary concerns and joint families). Of the deposit accounts, 28% were term deposits while 72% were current or savings deposits.

2.31 The RBI had also attempted an analysis of the district-wise gaps in financial inclusion by Scheduled Commercial Banks disaggregated by population group features (viz., rural, semi-urban, urban and metropolitan). As the preponderance of financially excluded population occurs in rural and semi-urban areas, the analysis lays primary focus on this group. To arrive at the gaps in financial inclusion, the district-wise population and the number of credit accounts held by the scheduled commercial banks, separately for the rural and semi-urban branch offices were taken. Taking the difference of per branch population and per branch credit accounts, the gaps in financial inclusion, are estimated.

2.32 The Committee has perused the analysis made by RBI. It agrees with the view that the inter-district variations are much sharper vis-à-vis the inter-State variations, which is only to be expected, taking into account the huge regional disparities in development indices.

2.33 For the purpose of addressing the issue of critical exclusion, the Committee identified those districts where the exclusion is most severe. For the same, it identified two parameters – districts with :

- Per branch rural and semi-urban population above 19,272 (AI average) *and*
- Credit Gap +95%

2.34 This analysis revealed that out of 583 districts, as many as 256 districts (spread over 17 States and 1 UT) fall in the above category. Almost all the major

States in the North-Eastern, Eastern and Central Regions are affected as well as a few districts in States like Gujarat, Rajasthan and Maharashtra. The district-wise, State-wise particulars are indicated in Annexure I. A summary of the analysis is provided in the following table :

Sr. No.	State	No. of districts	Range of credit gap (%)
1	Arunachal Pradesh	5	99.3 – 98.3
2	Assam	19	98.5 – 96.1
3	Bihar	37	98.6 – 95.0
4	Chhattisgarh	15	98.0 – 96.5
5	Dadra & Nagar Haveli	1	97.6
6	Gujarat	7	98.1 – 95.7
7	Haryana	5	96.9 – 95.4
8	Jharkhand	12	97.8 – 95.6
9	Madhya Pradesh	30	98.3 – 95.3
10	Maharashtra	20	98.0 – 95.1
11	Manipur	9	99.2 – 97.9
12	Meghalaya	1	99.0
13	Mizoram	1	98.3
14	Nagaland	6	99.3 – 98.2
15	Orissa	2	95.3 – 95.2
16	Rajasthan	14	97.8 – 95.2
17	Uttar Pradesh	58	98.6 – 95.1
18	West Bengal	14	97.1 – 95.2
	Total	256	

Note : The above analysis considers only commercial banks (including RRBs). Co-operatives (which have a strong presence in Gujarat, Maharashtra and Rajasthan) are not covered.

Source: Analysis by DESACS, RBI, New Delhi

Summing up

2.35 *Extent of Exclusion – NSSO Survey 59th Round*

(a) General :

- 51.4% of farmer households are financially excluded from both formal / informal sources (459 lakh out of 893 lakh).
- Of the total farmer households, only 27% access formal sources of credit; one third of this group also borrow from non-formal sources.
- Overall, 73% of farmer households have no access to formal sources of credit.

(b) Region-wise :

- Exclusion is most acute in Central, Eastern and North-Eastern regions – having a concentration of 64% of all financially excluded farmer households (from formal sources) in the country (415.61 lakh households out of 649.54 lakh households). Overall indebtedness to formal sources of finance alone is only 19.66% in these three regions (4.09% for North-Eastern Region, 18.74% for Eastern Region and 22.41% for Central Region).

(c) Occupational Groups :

- Marginal farmer households constitute 66% of total farm households. Only 45% of these households are indebted to either formal or non formal sources of finance (small farmers – 51%, medium farmers – 65.1% and large farmers – 66.4%).
- About 20% of indebted marginal farmer households have access to formal sources of credit (medium farmers – 57.6% and large farmers – around 65%).
- Among non-cultivator households nearly 80% do not access credit from any source.

(d) Social Groups :

- Only 36% of ST farmer households are indebted (SCs and Other Backward Classes - OBC - 51%) mostly to informal sources.

2.36 Analysis of the data provided by the Basic Statistical Returns of Scheduled Commercial Banks reveal that critical exclusion (in terms of credit) is manifest in 256 districts, spread across 17 States and 1 UT, with a credit gap of 95% and above. This is in respect of commercial banks and RRBs. Credit coverage by cooperatives is also on a relatively low level, as nearly 62% of its members are non-borrowing members.

2.37 While NSSO and BSR data (as indicated above) show critical exclusion as manifest in certain regions and social / economic groups, there are other sets of data which show a different picture. As per CMIE (March 2006), there are 11.56 crore land holdings. 5.91 crore KCCs have been issued as at the end of March 2006, which translated into a credit coverage of more than 51% of land holdings by formal sources. Further data with NABARD on the doubling of agricultural credit indicates that agricultural loan disbursements during 2006-07 covered 3.97 crore accounts.

2.38 Thus, there are different estimates of the extent of inclusion thru' formal sources. Further, the reference period of the data is also not uniform – the BSR statistics take 2004 as the base, CMIE 1995 (published March 2006), while NSSO covers position during 2003. Consequently, this has had an impact on quantifying the extent of levels of exclusion. RBI / NABARD should look into this aspect and study the reasons for such large differences arising in the estimate of levels of exclusion.

2.39 However, notwithstanding such differences in the data available, what can be stated with certainty is that exclusion exists – to a large extent among specific occupational groups, specific social groups and in specific regions, either in isolation or in conjunction. It is, therefore, imperative to roll out an action plan to cover the highly excluded areas / regions in a very definite, time-bound manner. Towards realizing this objective, the Committee recommends formulation of a National-level Action Plan, which is discussed in the next Chapter.

Chapter - 3

National Rural Financial Inclusion Plan

Strategy for Improving Financial Inclusion by Formal Credit Sources

3.01 The Committee is of the view that the overall strategy for financial inclusion, especially amongst the poor and disadvantaged segments of the population should comprise :

- Ways and means to effect improvements within the existing formal credit delivery mechanism.
- Suggest measures for improving the credit absorption capacity especially amongst the marginal and sub marginal farmers and poor non-cultivator households.
- Evolve new models for extending outreach.
- Leverage on technology solutions to facilitate large scale inclusion.

3.02 In Chapter II, the severity of exclusion has been examined from the angle of access to credit using data from NSSO 2003 study and the BSR reports of RBI. However, for triggering a mechanism of financial inclusion, the RBI has initiated a number of measures for achieving 100% financial inclusion in identified districts with particular emphasis on districts having a large SC/ ST population. A brief account of these initiatives are indicated in Annexure XI.

National Rural Financial Inclusion Plan (NRFIP)

3.03 The analysis in Chapter II clearly brings out the magnitude of severity of exclusion from the angle of access to credit. The Committee is clear that the task of financial inclusion must be taken up in a mission mode as a financial inclusion plan at the national level. Derived data from the NSSO Study shows that 64.95 million cultivator households and 46.6 million non-cultivator households respectively do not have access to formal financial services. While banks could target 100% coverage in respect of a No Frills basic bank account, a more realistic and clear target at the national level would be to provide access to comprehensive financial services, including credit, to atleast 50% of such households, say 55.77 million by 2012 thru' rural/ semi-urban branches of Commercial Banks and Regional Rural Banks. The remaining households, with such shifts as may occur in the rural/urban population, have to be covered by 2015.

3.04 In this context, the Committee notes that under the package for Doubling Flow of Agricultural Credit, commercial banks and RRBs were assigned a target of 100 new farmers to be covered per rural / semi-urban branch in the last two years. This target was achieved, indeed exceeded. Taking heart from this, the Committee is of the view that the semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and non-cultivator households per branch per annum, with an emphasis on financing marginal farmers and poor non-cultivator households.

3.05 The national targets would have to be disaggregated State-wise with adequate emphasis on districts having a large percentage of population not accessing bank credit, as indicated in the following table :

Analysis of State-wise Extent of Exclusion and Plan for Covering Excluded Households

Sr. No.	States / region	Formally excluded cultivator HHs (in 00)	Non cultivator HHs (in 00) *	Total HHs (in 00) *	50% coverage by 2012 (in 00) *	Total rural & semi urban branches of CBs + RRBs *	Per branch coverage over 5-years (no. of HHs) *	Per branch coverage p.a. (no. of HHs) *	
	Northern Region								
1	Haryana	11594	State-wise details not indicated in the NSSO Report	11594	5797.00	972	596	119	
2	Himachal Pradesh	7334		7334	3667.00	766	479	96	
3	Jammu & Kashmir	9162		9162	4581.00	648	707	141	
4	Punjab	11442		11442	5721.00	1783	321	64	
5	Rajasthan	42505		42505	21252.50	2538	837	167	
	Total	82037		82037	41018.50	6707	612	122	
	North Eastern R.								
6	Arunachal Pradesh	1217		1217	608.50	69	882	176	
7	Assam	24360		24360	12180.00	1042	1169	234	
8	Manipur	2114		2114	1057.00	55	1922	384	
9	Meghalaya	2541		2541	1270.50	147	864	173	
10	Mizoram	719		719	359.50	69	521	104	
11	Nagaland	670		670	335.00	72	465	93	
12	Tripura	1805		1805	902.50	148	610	122	
13	Sikkim	500		500	250.00	56	446	89	
	Total	33926		33926	16963.00	1658	1023	205	
	Eastern Region								
14	Bihar	65426		65426	32713.00	3078	1063	213	
15	Jharkhand	25645		25645	12822.50	1223	1048	210	
16	Orissa	28571		28571	14285.50	1913	747	149	
17	West Bengal	51531		51531	25765.50	2762	933	187	
	Total	171173		171173	85586.50	8976	954	191	
	Central Region								
18	Chattisgarh	20277		20277	10138.50	816	1242	248	
19	Madhya Pradesh	42656		42656	21328.00	2533	842	168	
20	Uttar Pradesh	139051		139051	69525.50	6032	1153	231	
21	Uttaranchal	8543		8543	4271.50	740	577	115	
	Total	210527		210527	105264.00	10121	1040	208	
	Western Region								
22	Gujarat	25469	25469	12734.50	2222	573	115		
23	Maharashtra	32607	32607	16303.50	3261	500	100		
	Total	58076	58076	29038.00	5483	530	106		
	Southern Region								
24	Andhra Pradesh	33613	33613	16806.50	3537	475	95		
25	Karnataka	28711	28711	14355.50	3101	463	93		
26	Kerala	8385	8385	4192.50	2725	154	31		
27	Tamil Nadu	21797	21797	10898.50	2979	366	73		
	Total	92506	92506	46253.00	12342	375	75		
28	Group of UTs	1295	1295	647.50	559	116	23		
	Grand Total	649540	466000	1115540	557770.00	45846	1217	243	

* In the State-level targets appropriate allowances have to be made for non-cultivator households, once detailed figures are available.

3.06 It may be observed that the per branch annual coverage envisaged under the plan is quite high in certain States of the North-Eastern, Eastern and Central regions.

The various recommendations made by the Committee have kept this in view for providing the needed support including financial assistance on a region-specific basis to banks operating in the above regions.

3.07 The strategy for achieving the above goal would comprise mapping out on a State-wise / district-wise basis, rural households having no access to formal sources of credit. The Committee is of the view that this task should be assigned to the District Level Consultative Committees (DLCC) of Banks on a priority basis, with instructions to proceed with the mapping exercise on a block-wise / district-wise basis, within the next 4 months. This should be dovetailed with the work being done by the monitoring mechanism set up at the district level for implementation of the recommendations of the CD Ratio Committee. The task would require, *inter alia*, the lead bank and the district administration placing appropriate personnel and material at the disposal of the DLCCs so that the task can be completed at the earliest. At the end of the exercise, each DLCC should be in a position to draw up block-wise / village-wise maps of households not having access to formal credit sources. This information should be disseminated widely and transparently by the DLCC in the district. Thereafter, at the State-level, a financial inclusion document (State Level Rural Financial Inclusion Plan – SLRFIP) should be prepared jointly by the State Level Bankers' Committee (SLBC) and NABARD, for arriving at the target of financial inclusion for the State. The target should clearly indicate the number of rural households not having currently any access to formal sources of credit and based on the mapping, indicate the number of households that will be provided such access by 2012. With a minimum target coverage of 50% of currently excluded, States will be free to set themselves higher targets.

3.08 The target will thereafter be allocated institution-wise, with each bank - commercial banks and RRBs. Other institutions like cooperative banks, NBFCs and MFIs may also be asked to join in the task of financial inclusion with self-set targets. Target setting by itself will not be sufficient. There is a need to bring about coordinated efforts of all the above players. Appropriate support instruments for achieving these targets have to be designed. The progress in implementation shall be reported and monitored at the DLCC and SLBC.

National Mission on Financial Inclusion

3.09 With a view to firming up the implementation of the recommendations of the Committee, it is proposed that GoI may consider constituting a National Mission on Financial Inclusion (NaMFI) comprising representatives from all stakeholders. The purpose of the Mission shall be to aim at achieving universal financial inclusion within a specific time frame. The Mission should be responsible for suggesting the overall policy changes required for achieving the desired level of financial inclusion, and for supporting a range of stakeholders – in the domain of public, private and NGO sectors - in undertaking promotional initiatives. Govt. may decide on appropriate representation from all stakeholders in the Mission.

Chapter – 4

Role of Commercial Banks

This Chapter briefly traces the historical and contemporary imperatives to provide financial services to the rural poor in India and the institutional responses to the same.

Evolution of the Financial Landscape

4.01 In post-independence India, in order to facilitate improvements in agricultural production and attain food self-sufficiency, the stance of policy was to ensure sufficient and timely credit at “reasonable” rates of interest to as large a segment of the rural population as possible (Rangarajan 1996). The strategy to achieve this was threefold: expansion of the institutional base, directed lending to disadvantaged borrowers, and credit provision at concessional rates of interest. The latter was justified in terms of the perceived mismatch between the longer term returns of farm investment in relation to cultivator households’ short term consumption needs and requirements to service the loans.

4.02 Fisher and Sriram (2006) identify three post-independence phases in rural credit provision. First, the 1950’s up to the mid-1960’s when cooperatives were the institutional vehicles of choice; second, the 1970’s and 1980s when attention shifted to commercial banks and RRBs and third, the reform period in the early 1990’s which saw the re-structuring of the banking system, the emergence of SHGs and a growing number of MFIs.

4.03 In terms of scale, spread, costs, risks, and the inter-temporal nature of credit markets, financial institutions and agents in India face formidable challenges in meeting the diverse financial service needs of the country’s rural population.

4.04 The present rural financial infrastructure comprises a wide variety of formal, semi-formal and informal financial service providers, with distinctive cultures and characteristics. The number of organisations and agents is very substantial : 33,553 rural and semi-urban branches of commercial banks, 13,932 rural and semi-urban branches of Regional Rural Banks, 1.09 lakh primary cooperatives, 1,000 NGO-MFIs and around 20 MFIs registered as companies (Section 25) and nearly three million SHGs. Even more numerous are the myriad of informal agents constituting a great range of financial service providers across the country.

4.05 Different segments of the financial infrastructure have not developed uniformly or simultaneously, and their relative standing in terms of government policy and intervention has changed over time. Moreover, financial institutions have themselves influenced government policy (Jones 2006). In the following paragraphs, an attempt is made to trace the forces and compulsions that have led to the development of particular rural financial institutions in the country, to outline the changing fortunes and shares of these different systems, to show the present gap between rural financial needs and provisions, and to assess policy options to reduce this gap through institutional development, linkages and reform.

Evolution of Commercial Banks

4.06 The foundation for building a broad base of agricultural credit structure was laid by the Report of the All-India Rural Credit Survey (AIRCS) of 1954. The provision of cultivator credit in 1951-52 was less than 1% for commercial banks. In the report it was observed that agricultural credit fell short of the right quantity, was not of the right type, did not fit the right purpose and often failed to go to the right people. With a view to give an impetus to commercial banks, particularly, in the sphere of investment credit, the nationalization of the Imperial Bank of India and its redesignation as the State Bank of India (SBI) was recommended.

Growth in Outreach 1951-91

4.07 From the position prevalent in 1951-52, commercial banks came a long way with a substantial spread of 32,224 branches in rural and semi-urban areas comprising 68% of their total outlets as on 31 March 1991. The outstanding deposits of such branches at Rs.67,855 crore as on the same date constituted around 35% of their total deposits, while loans outstanding at Rs. 43,797 crore comprised 36% of outstanding credit. The agricultural advances of the commercial banking system aggregated Rs. 16,687 crore and constituted 14% of total advances in March 1991. The rural and semi-urban branches of commercial banks covered 17.6 crore deposit accounts while the number of loan accounts serviced aggregated 3.7 crore.

Growth during 1991-92 to 2003-04

4.08 The period since 1991-92 has seen a fairly rapid expansion of credit to agriculture. Available data indicate that the flow of credit to agriculture by commercial banks and RRBs taken together increased to Rs. 60,022 crore in 2003-04. This implies a compounded annual growth rate of 22.2%. In fact, as compared with commercial banks (including RRBs), the flow of credit from the cooperative sector was much slower through this period. The compounded annual growth rate of credit for agriculture from cooperative institutions was only 13.7%. Further, the proportion of agriculture credit to total credit came down because of the rapid growth in non-agriculture credit.

4.09 The Government took some major initiatives during the period to boost agriculture production and productivity through enhanced credit flow and by way of building agricultural infrastructure, particularly irrigation and connectivity in rural areas.

4.10 Special Agricultural Credit Plan (SACP) was introduced by RBI for Public Sector Commercial Banks in 1994-95. Credit growth for agriculture and allied sectors under this caption reflected a CAGR of 36.45% during 2001-02 to 2005-06. SACP has since been extended to Private Sector Commercial Banks from 2005-06.

4.11 The SHG – Bank Linkage Programme was started as a pilot project by NABARD in 1992. It led to the evolution of a set of RBI approved guidelines to banks to enable SHGs to transact with banks. Initially there was slow progress in the programme up to 1999 as only 32,995 groups were credit linked during the period 1992 to 1999. Since then the programme has been growing rapidly and the cumulative number of SHGs financed increased from 4.61 lakhs on 31 March 2002 to 10.73 lakhs on 31 March 2004 and further to 29.25 lakh groups as on 31 March 2007.

4.12 Rural Infrastructure Development Fund (RIDF) was set-up in NABARD by GoI during 1995-96 with an initial corpus of Rs.2000 crore, to accelerate the

completion of on-going projects of rural infrastructure. Banks which did not fulfill the priority sector credit requirement and agriculture credit mandate were required to contribute to this Fund. The fund has been strengthened every year with additional allocations in the Union Budget. A large number of irrigation and rural connectivity projects could get completed under RIDF.

4.13 RBI scaled down its contribution to the Rural Credit funds with NABARD to a token amount of Rs.1 crore per annum since 1993-94. However to enable NABARD to have reasonably strong leverage for accessing market funds, the share capital of NABARD was strengthened and increased to Rs.2000 crore (paid up) from Rs.100 crore at the time of its formation in 1982. Contributions to enhanced share capital have come from GoI and RBI. By prudent funds management, the institution has also built a strong base of reserves and has been using it in its business operations judiciously to keep lending rates to rural financial institutions at significantly lower than market costs.

Developments – Post 2003-04

4.14 Since 2003-04, there has been a substantial increase in the flow of credit to agriculture through commercial banks. Disbursements have increased from Rs. 52,441 crore in 2003-04 to Rs. 1,16,447 crore in 2005-06, reaching an annual growth of 43% each year. As envisaged in the GoI's strategy for “doubling of credit”, 95 lakh new farmers have been brought under the institutional fold and 1,383 agri-clinics opened. Commercial banks have also played a major role in the promotion of the SHG - bank linkage movement with more than 11.88 lakh groups being linked to banks for provision of credit. Reforms in the commercial banking system include removal of procedural and transactional bottlenecks including elimination of Service Area Approach, reducing margins, redefining overdues to coincide with crop cycles, new debt restructuring policies, one time settlement and relief measures for farmers indebted to non-institutional sources.

The Task Ahead

4.15 Commercial banks are now slowly coming to appreciate the business potential in financial inclusion and also the need for better involvement. RRBs who are expected to function with the social heart of cooperatives and financial acumen of commercial banks have a significant role to play in financial inclusion, especially in the post-amalgamation scenario. The vast postal network, leveraging on their immense outreach, could also be an effective vehicle for purveying financial services.

4.16 While, there is evidence that commercial banks have been cognizant of their social responsibility in regard to small farmers, their focus on marginal and sub-marginal farmers, tenants, share croppers, oral lessees and non-cultivator households, viz., the very poor and disadvantaged sectors has been found wanting. In the circumstances, there is a need to evolve conscious strategies for providing easier access to affordable credit to the marginal, sub-marginal and other disadvantaged groups in the rural sector. Such strategies should combine using a variety of delivery channels, intermediaries and IT solutions apart from the traditional brick and mortar branch network.

4.17 The **specific recommendations** of the Committee for achieving targets under the NRFIP by leveraging the existing commercial bank branch network in rural areas are as follows :

Targets for rural / semi-urban branches

4.18 Currently, there are 33,478 commercial bank branches in rural and semi-urban centres in the country. Out of these, there are about 12,340 branches in the rural and semi urban areas of the Central, Eastern and North-Eastern Regions, where the majority of the financially excluded population live. It is understood that each branch of Grameen Bank in Bangladesh services at least 4,000-5,000 borrowers, with 6-7 field officers per branch. Given the existing staff strength, it should be possible for commercial banks (including RRBs) to provide access to credit to at least 250 hitherto excluded households per annum at each of their existing rural and semi-urban branches. For this, banks will have to strengthen their staff and use a variety of delivery mechanisms.

Targeted Branch Expansion in identified districts

4.19 In several districts, the population per branch office is much higher than the national average, particularly in rural and semi urban areas. The list of such districts has already been circulated by RBI among banks. The DLCCs in these districts may identify centres for opening branches by commercial banks and RRBs. in the next three years.

4.20 For the North-Eastern Region, the financial sector plan has already identified such centres and branch expansion plan as laid out therein may be implemented. SLBC may monitor the branch expansion plan for each State.

Product Innovation

4.21 The excluded segments of the population require products which are customized, taking into consideration their varied needs. Their banking requirements being small, the issue of servicing and delivery in a cost-effective manner assumes significance. The need for savings by these groups require special attention, e.g. for meeting life cycle needs, creating assets, repaying high cost borrowings, meeting emergencies etc. The saving products offered at present do not effectively meet these needs. The services offered are also not suitable because of the spatial spread of the excluded people and also the small quantum of finance involved.

(a) Savings : Savings products to meet the specific requirements of the poor need to be evolved. One way of meeting this would be to utilize SHGs for tapping the small savings by providing incentives to the SHGs with suitable back-end technology support. The banks can develop medium and long term savings instruments by issue of pre-printed deposit receipts to the SHGs which in turn can be sold to the SHG members. Banks could be given the freedom to develop their own products, suiting local requirements and felt needs of the poor.

(b) Credit : With regard to credit products, the savings linked financing model can be adopted for these segments. The approach should be kept simple which should guarantee the beneficiaries a credit limit, subject to adherence to terms and conditions. The credit within the limit can be made available in 2-3 tranches, with the second and subsequent tranches disbursed based on repayment behaviour of the first tranche. This is to ensure that the vulnerable groups do not get into a debt trap; it also ensures good credit dispensation.

(c) Insurance : Banks can play a vital role in this regard – by distributing suitable micro-insurance products.

Incentivising Human Resource – Measurable performance indicators

4.22 Lending to low income groups and increasing financial inclusion need motivated bank staff. Such motivation is a function of attitudes and beliefs as also a system of incentives / disincentives put in place by the bank's management for special efforts / failures to achieve desired levels of financial inclusion.

4.23 The Committee debated the issue of creating a separate cadre of rural bank employees. While the arguments in favour were supported by the large proportion of rural branches, quantum of deposits and credit, the arguments against were the high costs involved and compulsions regarding rotation of staff. It was, therefore, felt that existing staff posted to rural branches can be incentivised within a framework of performance parameters including covering of new households through deposit and loan accounts, increase in business in existing and new small loan / deposit accounts, increase in number of SHGs / Joint Liability Groups (JLG) formed and credit linked, efforts put in for promotion of asset management skills and developing linkages to promote credit absorption.

Funding

4.24 The Committee recognized that there is a cost involved in providing credit plus services and technology applications. Such costs may come down over a period of time with the resultant business expansion. Banks are expected to meet a part of the costs. However, in the initial stages some funding support thru' specially constituted Funds may be extended to them. This funding support, envisaged as a mechanism to reduce costs, may be provided to the banks on two counts - (i) promotional and developmental initiatives that will lead to better credit absorption capacity among the poor and vulnerable sections and (ii) application of technology for facilitating the mandated levels of inclusion.

Financial Inclusion Funds

4.25 The Committee proposes the constitution of two funds – the Financial Inclusion (Promotion & Development Fund), with NABARD, for meeting the cost of developmental and promotional interventions indicated below and the Financial Inclusion Technology Fund, with NABARD, to meet the costs of technology adoption. Each Fund will have an initial corpus of Rs. 500 crore, with a start-up funding of Rs. 250 crore each, to be contributed in equal proportion by GoI / RBI / NABARD and with annual accretions thereto. Banks will be eligible for support from the Funds on a matching contribution of 50% from the Fund in regard to districts other than tribal districts and 75% in case of branches located in tribal districts identified under the Tribal Sub Plan.

Financial Inclusion Promotion and Development Fund

The Financial Inclusion Promotion and Development Fund will focus on financing the following interventions :

Farmers' Service Centres (FSC) :

4.26 With the creation of and support to FSCs a host of financial and farm advisory services are to be provided to the new / hitherto excluded customer segments. The Centres will network on the technology front with Agricultural Universities / KVKs, farmers clubs, the formal extension machinery of the State Governments, technical staff of banks, portals of national level commodity exchanges etc. Such FSCs can be financed by the banks on the pattern of agri clinics. In the

initial stages, it may be necessary to provide them some support by way of viability gap funding.

Promoting Rural Entrepreneurship :

4.27 Commercial banks may consider setting up institutions like farmer training centres and Rural Development and Self Employment Training Institutes (RUDSETI) for developing skills among farmers / rural entrepreneurs for effectively managing the assets financed.

Self-Help Groups :

4.28 The process of financial inclusion can be greatly facilitated through the medium of linking SHGs with the formal sector. It has been observed elsewhere in the Report that the SHG movement is yet to catch up on a big scale in regions manifesting high levels of exclusion (Central, Eastern and North-Eastern Regions). The funding support for promotion, nurturing and credit linking of SHGs can be extended.

Developing HR – Addressing attitudinal issues thru’ training :

4.29 Various studies have confirmed that lending to the poor raises a number of issues ranging from sources and reliability of their incomes to lack of suitable bank projects for them to the elitist approach of the formal institutional credit delivery apparatus. These factors are the outcome of attitudes towards the poor, as generally not viable and profitable customers of the bank. Experience indicates that the poor, if guided properly, not only succeed as entrepreneurs, but are also good “repayers”. However, changing this attitude or mindset is a challenge.

4.30 In a study conducted in Madhya Pradesh, it was found that attitudes of branch managers shape the branch lending behaviour. Two other important findings which emerged were that a majority of the branch managers held negative attitudes towards lending to the poor and about themselves, their work roles and situations and exhibited a general lack of motivation and confidence. Secondly, there was a positive correlation between the training received by the branch managers and their overall attitudes. Branch managers felt that in terms of frequency, and relevance to their work, training was inadequate, too theoretical, inappropriate for rural assignment, outdated and in some case a mere formality (Jones, Williams & Thorat).

4.31 Keeping in view the impact that training has on attitudes, a training module has been developed and tested for commercial banks and RRBs in the College of Agricultural Banking, Pune. The Committee recommends that banks use / adapt this programme for bringing about the right mindset amongst their branch staff posted to districts having a high share of population excluded from access to financial services.

Resource Centres

4.32 Resource Centres, apart from facilitating members of mature SHGs to graduate to micro-enterprises, also helps in ensuring long term sustainability of SHGs. The cost of setting up such centers can be met out of this Fund and / or the MFDEF. This is discussed in detail later in the report.

Federations

4.33 As indicated later in the report, funding support may also be extended from this Fund and / or MFDEF for voluntary establishment of federations.

Capacity building of BFs/BCs

4.34 Funding support, on priority basis, to be extended to specialized institutions which provide capacity building inputs to BFs/BCs, as discussed later in the Report.

Financial Inclusion Technology Fund

Technology Applications for Greater Financial Inclusion :

4.35 Extending outreach on a scale envisaged under NRFIP would require the application of low-cost technology solutions, which have been discussed in greater detail elsewhere in the Report. This may also call for certain levels of funding support for rolling out such IT-based inclusive financial sector plan.

Guidelines for operationalising the Funds

4.36 NABARD, in consultation with RBI, may prepare detailed guidelines based on consultations with commercial banks and technology service providers for operationalising both the Funds.

Procedural Changes

Simplifying Mortgage Requirements

4.37 The Talwar Committee had recommended acceptance of a simple declaratory charge as equitable mortgage. Enabling legislation has been passed in some States. This may be done by all the State Governments as it would simplify documentation processes considerably.

Exemption from Stamp Duty for Loans to Small and Marginal Farmers:

4.38 Stamp duty adds to transaction costs incurred by farmers. Non-availability of stamps in required denominations results in borrowers paying higher than the prescribed stamp duty. The Committee recommends waiver of stamp duty requirements for loan documents of small / marginal farmers and tenant cultivators.

Saral Documentation for Agricultural Loans

4.39 NABARD, in cooperation with a core group of bankers, has prepared a one page document for agricultural loans up to Rs.1 lakh. This document has been circulated among the scheduled commercial banks (including RRBs) with the approval of the Indian Banks' Association. The Committee recommends that this simplified document be adopted by all banks with a view to deepening credit outreach among the disadvantaged sections of the rural poor.

Nodal Branches (ADB Model)

4.40 Taking cognizance of the fact that the marginal and sub-marginal farmers require credit plus services in the form of extension services, in all districts identified as having the largest number of excluded people, the Committee recommends that one branch of the lead bank or the bank having the largest presence at the block / taluka level may be identified as the nodal branch to address the issue of exclusion. Lead banks or banks having the largest presence may strengthen these nodal branches with technical staff to provide agricultural / business development services in the farm and non-farm sectors respectively, comprising of technical inputs and extension services to the banks / farmers. These could either be provided by regular officers of the bank or local consultants / practitioners / agri-business clinics on a retainer basis. As the services of the nodal branch would be available to all other branches in the vicinity, an appropriate cost sharing arrangement may be worked out between various banks.

4.41 It is possible that in some districts the dominant presence is of the RRBs in which case sponsor banks may assist the RRBs in putting in place arrangements for technical staff for providing credit plus services for facilitating financial inclusion. NABARD may defray the cost of such technical staff, particularly, in the North-Eastern Region.

Business Facilitators / Business Correspondents (BF/BC)

4.42 With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, the RBI has permitted banks to use the services of NGOs / SHGs, MFIs and other civil society organisations as intermediaries in providing financial and banking services through the use of BF and BC Models vide their Circular of 25 January 2006.

Business Facilitator Model

4.43 Under the BF Model, banks may use intermediaries such as NGOs, farmers' clubs, cooperatives, community based organisations, IT-enabled rural outlets of corporate entities, post offices, insurance agents, well functioning Panchayats, village knowledge centres, agri-clinics / agri-business centres, Krishi Vigyan Kendras and KVIC / KVIB units for providing facilitation services. It has been clarified that such services may include :

- Identification of borrowers and fitment of activities,
- Collection and preliminary processing of loan applications,
- Creation of awareness about savings and other products, education and advise on managing money and debt counseling,
- Processing and submission of application to banks,
- Promotion and nurturing of SHGs / JLGs,
- Post sanction monitoring,
- Monitoring and hand holding of SHGs / JLGs / credit groups / others, and
- Follow-up for recovery.

Business Correspondent Model

4.44 Under the BC Model, NGOs / MFIs set up under the Societies / Trust Act, Societies registered under Mutually Aided Cooperative Societies Acts or the Cooperative Societies Acts of States, Section 25 Companies, Registered NBFCs not accepting public deposits and post offices may act as BCs. Banks have been advised to conduct due diligence on such entities and ensure that they are well established, enjoy good reputation and have the confidence of local people.

4.45 In addition to the activities listed under the BF Model, the scope and activities to be undertaken by BCs will include

- Disbursal of small value credit,
- Recovery of principal / collection of interest,
- Collection of small value deposits,
- Sale of micro-insurance / mutual fund products / pension products / other third party products, and

- Receipt and delivery of small value remittances / other payment instruments.

4.46 The activities to be undertaken by the BCs would be within the normal course of the banks' business, but conducted through the entities indicated above at places other than the banks' premises.

Operating Norms

4.47 Banks have been permitted to pay reasonable commission / fees to the BFs / BCs, the rate and quantum of which is to be reviewed periodically. Such costs have to be borne entirely by the banks. Initially, it may affect operational margins, but over time, on account of the incremental business brought in, the arrangement is expected to become viable and self-sustaining. Further, banks have been advised that the agreement with the BCs should specifically prohibit them from charging any fee to the customers directly for services rendered by them on behalf of the bank. It has been clarified that the arrangements with the BCs shall specify :

- Suitable limits on cash holding by intermediaries as also limits on individual customer payments and receipts,
- The requirements that the transactions are accounted for and reflected in the banks' books by end of the day or next working day,
- All agreements / contracts with the customer shall specify that the bank is responsible to the customer for acts of omission and commission of the BF / BC.

4.48 It was explained to the Committee that notwithstanding the dispensation given to banks, the response of the banking system was somewhat low key and that the model is yet to be fully grounded.

4.49 Discussions with a cross section of bankers revealed that the muted response was in part due to :

- Disinclination on part of banks to absorb the costs involved on grounds of its impact on viability of operations,
- Lack of clarity regarding certain procedural complexities.

4.50 Taking the totality of circumstances into account, specially the need to facilitate greater financial inclusion, the Committee makes the following **recommendations** insofar as the BF/BC Model is concerned:

Business Facilitators

4.51 Originally, only individuals who were insurance agents could act as BFs while no individuals could be placed as BC. This was later on widened to include retired officials, viz., Government servants like postmasters, school teachers and headmasters, who were considered eligible by RBI to act as BF. These people have a standing in the local community and provide the needed comfort level to the banks. The banks may make use of this relaxation and use individuals as indicated above as BF.

4.52 Ex-servicemen in rural areas have the comforting support, not only of the institutionalized ex-servicemen's fraternity but also of their Regional Centres. These Centres act as guide and monitor both serving and retired armed forces personnel. During discussions with the Committee, it was indicated that ex-servicemen would volunteer to act as BCs in selected districts having a high concentration of ex-

servicemen. The Committee is of the view that, initially, banks may appoint ex-servicemen and retired bank staff as their BFs.

4.53 Further, after identification and placement of BFs, the banks should ensure that the banking awareness created and potential identified by BFs get translated into business propositions by providing suitable banking services in the area. This could be attempted thru' mobile outlets, which could visit the various locations, as per a scheduled programme, so as to purvey banking services to the excluded.

4.54 To facilitate easy roll-out of this mobile banking model, banks should simplify and rationalize back-end processes and front-end procedures so that banking operations are made more customer-friendly.

Business Correspondents

4.55 With increasing competition, banks are getting to be quite wary of the reducing margins available to them on financial intermediation. Banks are, therefore, hesitant to opt for increasing their physical presence in upcountry/ remote locations entailing considerable capital/ operating costs. Under the present dispensation, small value clients (depositors) in remote locations get very little preference in accessing financial services. It is, therefore, imperative to have in place an arrangement which can cater to a large number of clients having irregular and low value transactions ensuring at the same time full protection of the interests of depositors. Such an arrangement is possible only by having a BC touchpoint in each of the 6 lakh plus villages serving as a customer interface at the front-end and backed by appropriate technology for its integration with the mainframe banking at the bank level. Keeping this in view, the following **recommendations** for the BC Model are made :

4.56 In addition to the institutions presently allowed by RBI to function as BCs, individuals like locally settled retired Government servants like postmasters, school teachers, ex-servicemen and ex-bank staff whose relationship with the banking system, through a pension account, has already been established, may be permitted to act as BCs.

4.57 Further, MF-NBFCs may be allowed to act as limited BCs of banks for only providing savings and remittance services.

4.58 The Committee recognizes the fact that technology has to be an integral part in sustaining outreach efforts thru' the BC model. Ultimately, banks should endeavour to have a BC touch point in each of the six lakh villages in the country. This is discussed in detail later in the Report.

4.59 With a view to encouraging the BCs to widen their client-base, a suitable incentive mechanism may be formulated by the banks, appropriately linked to the number of accounts opened / transactions put thru' by the BCs . This will go a long way in stabilizing the arrangement between the Banks and the BCs. Further, banks may consider identifying BCs even in areas where they have their own branches, so as to supplement their efforts in widening outreach and addressing access issues.

4.60 The Committee also observed that certain banks have already put in place intermediaries in the form of loan agents, who are akin to the BCs, (for undertaking loan disbursements and recovery) but in addition, also partake a certain element of risk / responsibility in case of loan defaults. In the initial stages, the BC model as envisaged by RBI could be implemented widely. In due course, when the BCs reach a higher level of turnover, they should bear commensurate financial responsibilities.

4.61 Banks may, at their discretion, appoint any individual/ institution of its choice as Business Correspondent, after exercising due diligence. This will facilitate greater acceptance of the BC Model by banks.

4.62 Funds may be provided to specialized institutions which provide capacity building inputs to BCs. Such funding support could be extended on priority basis to most excluded areas/ sectors of the society and met out of the Financial Inclusion Promotion & Development Fund.

4.63 SLBC convener banks may initiate discussion with their respective State Governments regarding routing government payments through BCs using the smart card or other relevant technology on a pilot basis.

4.64 SLBCs may undertake a study to identify organisations having the capacity to serve as customer service points and BC. In States like Andhra Pradesh and Kerala the VOs and Kudumbashree structures already exist and these can be used as customer service points.

4.65 Training modules for BFs/BCs may be prepared in vernacular and in culture sensitive pictorial forms.

Role of Commercial Banks in microfinance

4.66 Deepening the outreach of the microfinance programme is an effective way in reaching out to the excluded segments. Commercial Banks have played a very important role in the SHG-Bank Linkage Programme. As at the end of March 2007, as many as 50 Commercial Banks are involved in the programme, having linked 15.95 lakh SHGs, forming more than 54% of the total SHGs credit-linked in the country. This programme should be strengthened and carried further, playing a key role in financial inclusion.

Financing poor farmers

4.67 Joint Liability Groups (JLGs) of the poor such as landless, share croppers and tenant farmers is another innovative mechanism towards ensuring greater financial inclusion. This mechanism has already been operationalised in a few regions under a Pilot Project of NABARD. Commercial Banks can actively promote such groups for effectively purveying credit and other facilities to such clients. RBI may encourage banks to adopt the JLG model for lending to SF/MF, tenant cultivators, share croppers and oral lessees.

Making Marginal Farm Holdings Viable and Enabling their Financial Inclusion

4.68 The Committee examined the credit absorption capacity among marginal farm holdings and is of the view that :

- Farm aggregation models including contract farming fully protecting the interests of farmers could be an option for enhanced viability. Credit-marketing linkage can also be effected through appropriate agreements.
- Access to irrigation will make a substantial difference on viability of small farms. A massive programme for financing minor irrigation structures (wherever ground water levels are safe and surface water potential is available) may be undertaken specifically targeting marginal farm households.

- Supplementary activities like dairy, small poultry, sheep-rearing, etc. have to be specifically targeted for marginal farmers, tenants and non-cultivator households. In this context, the Committee notes that against an estimated production of 91 million tons of milk in 2004-05, the demand for milk in 2021-22 would increase to 172 million tons as per estimates of the Planning Commission. To meet the demand, milk production should continue to grow at 4% per annum for the next 15 years. The growth of milk production could be augmented through a two pronged approach focusing on improving production in major milk producing areas and expanding infrastructure for procurement, processing, marketing and quality assurance. A National Dairy Plan (NDP) has been prepared to target production enhancement in 323 potential districts. Under the NDP the following has been envisaged :
 - ❖ Financing dairy animals and dairy infrastructure to individuals, SHGs, cooperative societies, corporates, NGOs, etc after ensuring input and marketing linkages.
 - ❖ Establishment and encouragement of viable institutional structures through grants for institutional development, incentivising reforms by cooperatives.
 - ❖ Reform of existing dairy cooperatives.
 - ❖ Study of low potential districts to assist State Governments for developing dairy activities and evolving suitable plans.
 - ❖ Development of road and power infrastructure and watershed development in the identified areas under the NDP through RIDF loans to state governments.
 - ❖ The NDP would be implemented through a consortium of NABARD, the National Dairy Development Board (NDDB) and the National Cooperative Development Corporation (NCDC). The funds required for breeding, nutrition and milk handling are estimated to be Rs. 18,500 crore over the next three five-year plan periods. The assistance from the GoI would be Rs. 225 crore for the first year (2007-08).
 - ❖ It is recommended that similar initiatives may be considered for other sectors also like poultry, horticulture, etc.
 - ❖ Technical counseling and farm advisory services have to be extended to such farms which are provided finance for undertaking the above activities.

Towards Branchless Banking - A New Operating Model

Developed by Corporation Bank

A project implemented by Corporation bank at select locations across four Southern States has used modern ICT applications at remote rural locations. The project uses biometric card based authentication devices, which are used by the bank's Business Correspondents at the villages. The Bank is providing basic banking services to the rural people through these low cost devices, without the concomitant costs associated with setting up of an Extension Counter/ATM or a Branch and thus aiming to bring down significantly the transaction costs in rural banking. This model reportedly brings in a win-win situation for both the Bank and its rural customer. The services are made available close to their homes, obviating the need to spend time and money on transport to reach the branch. The roll out and maintenance costs of this model are only a fraction of running a conventional branch.

The Bank developed the new operating model to cover a large number of un-banked villages. The various steps taken by the Bank in this regard were:

- A village survey was conducted to assess the present level of household income generation and the potential of credit requirements in future;
- The household survey report served as an enabling tool to arrive at a total economic view of the families surveyed, potential for savings and the extent of credit that can be delivered;
- While conducting the survey, the Bank observed that many of the villages were reluctant to visit the bank branches for various reasons like long distance to be travelled, time lost, difficulty in following procedures and reluctance to visit branches for small value transactions.
- The Bank adopted a branchless banking model in select locations in four Southern States using a small Point Of Transaction (POT) device developed by two local vendors using a bouquet of locally available ICT applications.
- The adoption of new technology facilitated basic identification of the customer based on the survey details, eliminated procedural hassles like filling up challans, cheques, etc. for depositing/withdrawing money, provided automated voice guidance to the users in local language, etc. The device adopted was sturdy with a battery back-up to supplement long hours of power outage and could be connected to a car battery. The device was installed at the premises of the Business Correspondent at the village and the customers at village could visit the Business Correspondent at their convenience to carry out cash deposit or cash withdrawal. To facilitate transactions at the Business Correspondent's level, biometric cards containing the photograph and the basic KYC details of the customer were provided to identified villagers.
- The Bank has recently introduced on a pilot basis a loan product which would facilitate loan withdrawals and repayments involving small sums at the Business Correspondent level.
- The Bank is also planning to introduce remittance products for the card holders and factor in Government payouts such as pension, NREGP payments, etc. through the card holder's account.
- The Bank plans to commence a project to disburse group loans through the Business Correspondent to SHGs.
- The Bank intends to provide ancillary services like Utility Payments, Mobile bill payments, etc., through this account.

Chapter – 5

Regional Rural Banks

Introduction

5.01 Regional Rural Banks were established under the provisions of an Ordinance promulgated on the 26th September 1975 and the RRB Act, 1976 with an objective to ensure sufficient institutional credit for agriculture and other rural sectors. The RRBs mobilize financial resources from rural / semi-urban areas and grant loans and advances mostly to small and marginal farmers, agricultural labourers and rural artisans. The area of operation of RRBs is limited to the area as notified by GoI covering one or more districts in the State.

5.02 RRBs are jointly owned by GoI, the concerned State Government and Sponsor Banks (27 scheduled commercial banks and one State Cooperative Bank); the issued capital of a RRB is shared by the owners in the proportion of 50%, 15% and 35% respectively.

Reform Process

5.03 RRBs started their development process on 2nd October 1975 with the formation of a single bank (Prathama Grameen Bank). As on 31 March 2006, there were 133 RRBs (post-merger) covering 525 districts with a network of 14,494 branches. RRBs were originally conceived as low cost institutions having a rural ethos, local feel and pro poor focus. However, within a very short time, most banks were making losses. The original assumptions as to the low cost nature of these institutions were belied.

5.04 When the reform process in the banking sector was initiated, RRBs were taken up for a close look. The GoI in consultation with RBI and NABARD started the reform process thru' a comprehensive package for RRBs including cleansing their balance sheets and recapitalising them. Extant lending restrictions were removed and space and variety available for investment of their surplus funds was expanded. Simultaneously, a number of human resource development and Organisational Development Initiatives (ODI) were taken up by NABARD with funding support of the Swiss Development Corporation (SDC) and with the tools of training and exposure visits, ODI, technology support, computerization and use of IT, system development, etc. for business development and productivity improvement. By end March 2005, there was a remarkable improvement in the financial performance of RRBs as compared to the position prevailing in 1994-95. The number of banks reporting profits went up to 166 of the 196 RRBs. As on 31 March 2006, of the total 133 RRBs (post merger), 111 posted profits and 75 of these RRBs were sustainably viable organisations having no accumulated losses as also posting current profits.

5.05 GoI initiated the process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a State as per the recommendations of the Vyas Committee (2004). The amalgamated RRBs were expected to provide better customer service due to better infrastructure, computerization of branches, pooling of experienced work force, common publicity / marketing efforts, etc. and also derive the benefits of a large area of operation, enhanced credit exposure limits and more diverse banking activities. As a result of the amalgamation, the number of RRBs was reduced from 196 to 133 as on 31 March, 2006 and to 96 as on 30 April 2007. Thus,

under the amalgamation process, 145 RRBs have been amalgamated to form 45 new RRBs.

District Coverage

5.06 RRBs covered 525 out of 605 districts as on 31 March 2006. After amalgamation, RRBs have become quite large covering most parts of the State in many cases. Assam Gramin Vikas Bank, an amalgamated RRB, covers 25 districts, the highest in the country, while five other amalgamated RRBs cover 10 or more districts each. However, 40 RRBs covered two districts and 16 RRBs covered a single district each in 2005-06. Increased coverage of districts by RRBs makes them an important segment of the Rural Financial Institutions (RFI) for financial inclusion.

Branch Network

5.07 The number of branches of RRBs increased to 14,494 as on 31 March 2006 from 13,920 branches as on 31 March 1989. The network of the 45 amalgamated RRBs (as on April 2007) was quite large and diverse varying from 85 to 680 branches. The Uttar Bihar KGB, an amalgamated RRB, has 680 branches, followed by Baroda Eastern UPGB with 539 branches. The branch network of stand-alone RRBs varied between 8 and 242 as on 31 March 2006.

Key Performance Indicators

5.08 Reforms introduced in RRBs by GoI in consultation with RBI and NABARD have yielded positive results in respect of key performance indicators, as indicated under :

Key Performance Indicators : RRBs

Amount Rs. crore

Sr. No	Indicator	31.03.2004	31.03.2005	31.03.2006
1	No. of RRBs	196	196	133
2	No. of districts covered	518	523	525
3	No. of branches	14446	14484	14494
4	No. of staff	69249	68912	68629
5	Owned funds	5438	6181	6647
6	Deposits	56350	62143	71329
7	Borrowings	4595	5524	7303
8	Investments	36135	36761	41182
9	Loans outstanding	26114	32870	39713
10	Credit-deposit (CD) ratio	46%	53%	56%
11	Loans issued	15579	21082	25427
12	No. of RRBs having accumulated losses	90	83	58
13	Accumulated losses	2725	2715	2637
14	No. of RRBs in profit	163	166	111
15	Net NPA (%)	8.55%	4.84%	3.99%
16	Recovery (%) (as on 30 June)	73%	78%	80%
17	Per branch productivity	5.71	6.56	7.66
18	Per staff productivity	1.19	1.38	1.62

The following trends can be highlighted :

- 111 RRBs out of total 133 registered profit in the year 2005-06.

- CD Ratio has been increasing from 46% on 31 March 2004 to 53% on 31 March 2005 and further to 56% on 31 March 2006.
- Recovery percentage has been improving from 73% during 2003-04 to 80% during 2005-06.
- Consequently, net NPAs have declined from 8.55% on 31 March 2004 to 3.99% on 31 March 2006.
- Loans disbursement registered an impressive 35% annual growth in 2004-05 and 21% in 2005-06.
- Per branch productivity has increased from Rs. 5.71 crore on 31 March 2004 to Rs. 7.66 crore on 31 March 2006.
- Per staff productivity has increased from Rs.1.19 crore on 31 March 2004 to Rs.1.62 crore on 31 March 2006.
- There has been a decline in the total number of staff.

Performance under “Doubling of Agriculture Credit” : RRBs

5.09 More importantly, the performance of RRBs under GoI's initiative on doubling of agriculture credit in three years (from base year 2003-04) and greater coverage of small and marginal farmers, have been impressive. They disbursed agriculture loans of the order of Rs. 12,404 crore during 2004-05 registering a phenomenal annual growth of 64% against the targeted 30%. During 2005-06, agriculture credit flow stood at Rs. 15,223 crore with a growth of 23%. Thus, RRBs have achieved the target of doubling of agriculture credit in 2 years. RRBs financed 18.58 lakh new farmers in 2004-05 and another 17.03 lakh new farmers in 2005-06.

RRB's Potential Role in Financial Inclusion

5.10 Post-merger RRBs represent a powerful instrument for financial inclusion. Their outreach vis-à-vis other scheduled commercial banks particularly in regions and across population groups facing the brunt of financial exclusion is impressive, as observed from an analysis of Basic Statistical Returns of the RBI and indicated in the following paragraphs. With merger infusing the much needed financial strength in RRBs coupled with the local feel and familiarity they command, RRBs are in a unique position to play a decisive role in financial inclusion.

Outreach

5.11 In rural areas, RRBs account for a substantial 37% of total offices of all scheduled commercial banks. In semi-urban areas, their share comes to 15%. It goes without saying that exclusion is more severe in rural areas.

Offices of Scheduled Commercial Banks - Population Group and Bank Group-wise (March 2005)

Bank group	Rural offices		Semi-urban offices		Urban / metro offices		Total	
	No.	% to total	No.	% to total	No.	% to total	No.	% to total
RRBs	11824	37	2284	15	537	2	14645	21
SCBs other than RRBs	20143	63	13335	85	21846	98	55324	79
Total	31967	100	15619	100	22383	100	69969	100

Manpower Deployment

5.12 91% of the total workforce in RRBs is posted in rural and semi-urban areas as compared to 38% for other scheduled commercial banks (table below) . Even in absolute terms, out of a total workforce of 179,423 deployed by all scheduled commercial banks in rural areas, RRBs share is 25% (45,062). This is significant considering that at all India level, manpower of RRBs constitute only 7% of the total manpower of all scheduled commercial banks.

Distribution of Employees of Scheduled Commercial Banks (March 2005)

Bank group	Total employees	% of employees posted in rural branches	% of employees posted in semi-urban branches	% of employees posted in urban / metro branches
RRBs	65599	69	22	9
SCBs other than RRBs	834834	16	22	62
Total	900433	20	22	58

Savings Mobilisation

5.13 At all India level, RRBs account for 12% of all deposit accounts of scheduled commercial banks and a meagre 3.5% of deposit amount. However, in rural areas, RRBs share in deposit accounts is a significant 31% and that in deposit amount 19%. This shows that the average deposit amount is lower in RRBs than other commercial banks, thereby implying RRBs' better reach to small depositors.

Deposits of Rural Branches of Scheduled Commercial Banks - Bank Group-wise (March 2005)

Bank group	No. of accounts		Deposit amount	
	No. ('000)	% to total	Amount (Rs. cr.)	% to total
RRBs	43540	31	40957	19
SCBs other than RRBs	98368	69	172147	81
Total	141908	100	213104	100

5.14 If we include semi-urban areas for both RRBs and scheduled commercial banks, RRBs' share in deposit accounts and amount stands at 21% and 11% respectively.

Deposits of Rural / Semi-urban Branches of Scheduled Commercial Banks - Bank Group-wise (March 2005)

Bank group	No. of accounts		Deposit amount	
	No. ('000)	% to total	Amount (Rs. in cr.)	% to total
RRBs	55165	21	56111	11
SCBs other than RRBs	211941	79	452678	89
Total	267106	100	508789	100

Credit Disbursed

5.15 At all India level, RRBs account for 18% of loan accounts of all scheduled commercial banks and 3% of loans outstanding. However, in rural areas the share of RRBs in loan accounts is an impressive 38%. More significantly, despite having 38% of all loan accounts, RRBs account for only 21% of total credit outstanding in rural areas, implying thereby their better reach to small borrowers.

Credit Disbursed by Rural Branches of Scheduled Commercial Banks - Bank Group-wise (March 2005)

Bank group	No. of accounts		Credit outstanding	
	No. ('000)	% to total	Amount (Rs. in cr.)	% to total
RRBs	10913	38	23017	21
SCBs other than RRBs	18155	62	86959	79
Total	29068	100	109976	100

5.16 If semi-urban branches are included, the share of RRBs in credit accounts and amount outstanding is of the order of 29% and 13% respectively.

Credit Disbursed by Rural and Semi-urban Branches of Scheduled Commercial Banks - Bank Group-wise (March 2005)

Bank group	No. of accounts		Credit outstanding	
	No. ('000)	% to total	Amount (Rs. cr.)	% to total
RRBs	13677	29	30546	13
SCBs other than RRBs	33594	71	210071	87
Total	47271	100	240617	100

5.17 Both deposit and credit data indicate that RRB branches in rural areas have performed better in relation to other scheduled commercial bank branches. However, RRBs' share comes down significantly when data for both rural and semi-urban areas are considered. This could be due to the fact that branches of other scheduled commercial banks located in semi-urban areas disburse considerable loans in rural areas also. This is significant from the point of view of financial inclusion as rural branches are closer and more active in extending outreach to remote and interior villages. Viewed from this angle RRBs are particularly well placed to achieve the goal of financial inclusion.

Outreach across Regions

5.18 The table below points to RRBs' significant presence in North-Eastern, Eastern and Central Regions which manifest financial exclusion of a high order. Of all the scheduled commercial banks, RRBs account for 34% of branches in North-Eastern, 30% in Eastern and 32% in Central Regions whereas their presence is significantly lower (9% to 17%) in other regions. The data points to the fact that as an institutional group, RRBs are best suited to take up the leadership role in financial inclusion across priority areas in States of North Eastern, Eastern and Central Regions featuring high levels of exclusion.

**Offices of Scheduled Commercial Banks - Region- and Bank Group-wise
(March 2005)**

Regions	RRBs		Other SCBs		Total
	No.	% of total in the region	No.	% to total in the region	
Northern	1937	17	9627	83	11564
North-Eastern	659	34	1283	66	1942
Eastern	3617	30	8594	70	12211
Central	4545	32	9451	68	13996
Western	982	9	9912	91	10894
Southern	2905	15	16457	85	19362
Total	14645	21	55324	79	69969

Savings Mobilisation across Regions

5.19 Although RRBs account for only 12% of total number of deposit accounts at all India level, their share is significantly higher (18% to 29%) in the North-Eastern, Eastern and Central Regions where major interventions are required for financial inclusion. Further, the share of RRBs in a region in terms of no. of accounts is significantly higher than in terms of amount of deposits in the same region. This points to the fact that they basically cater to small depositors or the small depositors are more inclined towards RRBs.

**Deposits of Scheduled Commercial Banks - Region- and Bank Group-wise
(March 2005)**

Regions	No. of accounts ('000)		Amount (Rs. crore)	
	RRBs	Other SCBs	RRBs	Other SCBs
Northern	5570 (7%)	75157 (93%)	8225.26 (2%)	402179.85 (98%)
North-Eastern	3015 (29%)	7327 (71%)	2950.09 (11%)	24850.91 (89%)
Eastern	13085 (18%)	60868 (82%)	14400.73 (7%)	194611.28 (93%)
Central	20528 (22%)	71782 (78%)	20651.99 (9%)	198854.37 (91%)
Western	3271 (4%)	76390 (96%)	3348.75 (1%)	489284.78 (99%)
Southern	12219 (9%)	117581 (91%)	11870.08 (3%)	375585.96 (97%)
Total	57688 (12%)	409105 (88%)	61446.90 (4%)	1685367.15 (96%)

Credit Disbursed across Regions

5.20 RRBs account for about one third of total number of credit accounts in North-Eastern, Eastern and Central Regions as against only 18% at all India level as detailed in the Table below. Further, the average loan amount disbursed by RRBs is significantly less than by other scheduled commercial banks. In North-Eastern Region, RRBs account for 36% of loan accounts but only 13% of the outstanding loan amount. For Eastern Region, the respective shares are 35% and 6% and for Central Region they are 31% and 10%. It is obvious, RRBs command better outreach and level of comfort for small borrowers.

Credit of Scheduled Commercial Banks – Region & Bank Group-wise (Mar '05)

Regions	No. of accounts ('000)		Outstanding amount (Rs. crore)	
	RRBs	Other SCBs	RRBs	Other SCBs
Northern	967 (12%)	7043 (88%)	4091.03 (2%)	240118.72 (98%)
North-Eastern	489 (36%)	886 (64%)	1218.26 (13%)	8514.40 (87%)
Eastern	3590 (35%)	6575 (65%)	6147.17 (6%)	88943.56 (94%)
Central	3617 (31%)	8086 (69%)	8577.20 (10%)	80969.11 (90%)
Western	659 (6%)	11233 (94%)	1696.19 (-)	409595.05(100%)
Southern	4845 (14%)	29160 (86%)	10958.97 (4%)	291638.27 (96%)
Total	14167 (18%)	62983 (82%)	32688.82 (3%)	1119779.11 (97%)

Self Help Groups - Bank Linkage

5.21 The microfinance services provided through SHG - bank linkage has so far been the most successful initiative in financial inclusion. Therefore, an analysis of RRB's involvement in the SHG movement will be an important indicator of the kind of mandate which RRBs could be given for further widening and deepening of financial inclusion.

5.22 Of the total 22.38 lakh SHGs credit linked by the banking industry as on 31 March 2006, 33% linkages were done by RRBs as detailed in the Table below. This is impressive by any standard. More significantly, the more backward a region is, the greater is the share of RRBs. In North-Eastern Region, the share is 56%, in Central Region it is 48% and in Eastern Region it reaches 40%.

5.23 Also in terms of bank loans provided cumulatively until March 2006 to SHGs, the share of RRBs is an impressive 29% with higher shares in North-Eastern, Eastern and Central Regions. State-wise particulars are indicated in Annexure II.

SHG - Bank Linkage : Cumulative No. of Groups Linked - Region-wise Participation by RRBs Versus Other Banks (March 2006)

Regions	No. of SHGs credit linked		
	by RRBs	by all banks (including coop.)	% by RRBs
Northern	45772	133097	34
North-Eastern	35108	62517	56
Eastern	159652	394351	40
Central	128390	267915	48
Western	34424	166254	21
Southern	336678	1214431	28
Total	740024	2238565	33

SHG - Bank Linkage : Cumulative Bank Loans - Region-wise Participation by RRBs Versus Other Banks (March 2006)

Regions	Cumulative bank loans (Rs. in crore)		
	By RRBs	By all banks	% by RRBs
Northern	125.64	398.58	32
North-Eastern	57.09	165.70	34
Eastern	367.72	935.42	39
Central	352.14	805.00	44
Western	116.11	525.14	22
Southern	2303.44	8567.69	27
Total	3322.14	11397.53	29

RRBs as Self Help Promotion Institutions (SHPI)

5.24 RRBs have not only provided financial services to the SHG-Bank Linkage Programme, but have also played a significant role as SHPIs. As many as 104 RRBs (31 March 2006) are also functioning as SHPIs with grant assistance from NABARD. Non-availability of good NGOs is a matter of concern especially in North-Eastern, Central and Eastern Regions. RRBs can play a vital role as SHPIs in such areas.

5.25 The foregoing paragraphs conclusively indicate that RRBs are well positioned to play a major role in financial inclusion particularly in areas / regions with high rates of financial exclusion. RRBs were originally created to cater to neglected sections / areas as they were expected to have sound financial management combined with local feel and familiarity. With the amalgamation of RRBs, they have acquired the critical mass in terms of financial strength to widen and deepen their outreach. With the requisite strength having been developed, RRBs are the best suited vehicles to widen and deepen the process of financial inclusion. However, utmost care must be taken to ensure that in the process of fulfilling the socio-economic objective of financial inclusion, RRBs' do not again fall into the vicious circle of deteriorating financial performance and deviation from their mandate. RRBs may be provided adequate promotional and developmental assistance to contribute substantially to financial inclusion in a way that the business generated out of inclusion efforts add positively to their performance.

Recommendations

5.26 RRBs should extend their services into unbanked areas and increase their credit to deposit (CD) ratio. As on 31 March 2006, 37 RRBs had CD ratio of less than 40%, 44 RRBs between 40% and 60% and 52 RRBs above 60%. The CD ratio variations ranged from 20% to 116%. As RRBs operate with branches in remote, interior and tribal-dominated areas, they have a special role to play in financial inclusion. The NRFIP, details of which are specified earlier, is of high relevance for RRBs, particularly those having CD ratio of less than 40%. The post-merger scenario of RRBs poses a series of challenges for them and needs to be addressed. The following areas would require attention from the point of view of financial inclusion.

- Setting exclusive targets for microfinance and financial inclusion,
- Providing funding support &
- Providing technology support

Keeping the above in view, the following specific **recommendations** are made :

No further merger of RRBs

5.27 There is a need for policy refinement regarding further merger of RRBs. The Vyas Committee had recommended merger of all RRBs in the same State. Currently, RRBs of the same sponsor bank are merged at State-level. By April 2007, the number of RRBs was reduced to 96. If sponsor banks are to have the requisite initiative to support their RRBs fully, they would need assurance that there will be no further mergers. The Committee is of the view that further merger of all RRBs at State-level is not required. It may also not be desirable if there has to be a firm reinforcement of the rural orientation of these institutions with a specific mandate on financial inclusion. The Committee, therefore, recommends that the process of merger should not proceed beyond the level of sponsor bank in each State.

Recapitalisation of RRBs with negative Net Worth

5.28 Recapitalisation of RRBs with negative net worth has to be given a serious consideration as it would facilitate their growth, provide lenders a level of comfort and enable their achieving standard capital adequacy ratios. As on March 2004, 98 RRBs were in need of Rs. 3,050 crore for making the net worth positive. The position, as on 31 March 2006, is that 40 RRBs would require Rs.1,718 crore.

Widening network and Expanding coverage

5.29 As on 01 April 2007, RRBs were covering 535 districts. They may be directed to cover all unbanked areas in these districts, taking the village as a unit, either by opening a branch (wherever feasible) or through the BF / BC model in a time bound manner. As on 01 April 2007, 87 districts in the country were not covered by RRBs and their area of operation may be extended to cover these districts.

Strategic microfinance plan with NABARD support

5.30 RRBs have the potential and capability to emerge as niche operators in microfinance. They are playing a major role in the SHG - Bank Linkage Programme especially also as SHPIs. It is significant that as an institution they have the expertise and potential to fulfill both the requirements of SHGs - formation plus nurturing and financial service provisions (credit plus). Their dual role has special meaning in areas which face severe financial exclusion and which do not have a sufficient presence of well performing NGOs. However, to upscale the programme to a level where it can really make a visible impact, RRBs need handholding particularly in the areas of training, promotion and development. NABARD may provide required assistance.

5.31 NABARD should prepare a strategic action plan RRB-wise, for promotion and credit linkage of SHGs. RRBs may be asked to form, nurture and credit link at least 3,000 SHGs in all districts covered by them in North-Eastern, Eastern and Central Regions. A Memorandum of Understanding (MoU) may be signed by RRBs with NABARD for a period of 5 years - with NABARD providing the promotional and development assistance out of the "Financial Inclusion Promotion and Development Fund" and RRBs forming, nurturing and providing financial services to SHGs. RRBs may accomplish the task with the support of individual rural volunteers, BFs, their staff members, etc. NABARD may closely monitor the programme - with focus on qualitative aspects.

NRFIP for RRBs

5.32 The strategy recommended earlier in the Report for NRFIP for commercial banks would be equally applicable for RRBs. The process of undertaking a survey, identification of excluded households, dissemination of the information, setting of bank-wise / branch-wise targets, etc., could be followed. RRBs will have certain handicaps in executing the Plan. They would require promotional, funding and technology support in different areas as outlined below. RRBs may endeavour to cover a large part of their incremental lending thru' the group mode (SHGs/JLGs) as it will enhance their outreach to the financially excluded. Lending thru' group mode would also keep NPAs at low level.

Pilot testing of BF / BC Model by RRBs

5.33 RRBs should adopt the BF and BC models as a major strategy of financial inclusion. NABARD should extend the required support including running pilots in selected banks. The proposal for a technology based intervention under the BF/ BC

model would be equally relevant for RRBs. However, RRBs would require some handholding in implementing the proposal. NABARD may identify 10 RRBs across the country, giving greater weightage to regions manifesting higher levels of financial exclusion and work in strategic alliance with these RRBs and their sponsor banks in implementing the proposal. The RRBs identified by NABARD for the project will require to develop a core banking software for proper integration of the technology model proposed. NABARD should enter into a MoU with identified sponsor banks and RRBs and provide initial funding and technology support.

Separate credit plan for excluded regions

5.34 The Committee recommends that RRBs operating in predominantly tribal areas and having high levels of exclusion may prepare annual credit plans having a separate component for excluded groups, which would integrate credit provision with promotional assistance such as agricultural services and BDSs for the farm and non-farm sectors respectively including entrepreneurship development and formation and strengthening of producer's organisations like dairy cooperatives. Refinance and promotional support may be provided by NABARD to RRBs on a large scale for implementation of these credit plans.

Computerisation

5.35 With a view to facilitate the seamless integration of RRBs with the main payment system, there is a need to provide computerisation support to them. Banks will be eligible for support from the Financial Inclusion Funds on a matching contribution of 50% in regard to districts other than tribal districts and 75% in case of branches located in tribal districts under the Tribal Sub Plan.

Strengthening Boards of Management

5.36 Further, now that RRBs are being merged and are becoming large size entities, it is necessary that their Boards of Management are strengthened and powers delegated to them on policy and business operations, viz. introduction of new liability and credit products, investment decisions, improving market orientation in raising and deployment of resources, non-fund based business, career progression, transfer policy etc.

Tax Incentives

5.37 From 2006-07, RRBs are liable to pay income tax. To further strengthen the RRBs, profits transferred to reserves could be exempted from tax till they achieve standard capital adequacy ratios. Alternately, RRBs may be allowed tax concessions to the extent of 40% of their profits, as per provisions under Sec. 36 (1) (viii) of the Income Tax Act.

NABARD to support HR development in RRBs

5.38 RRBs should serve, with the support of NABARD, GoI, RBI and the sponsor banks, as active financial inclusion players especially in areas with high levels of financial exclusion. In order to build up the skills and expertise of the personnel of RRBs, NABARD has played a crucial role since the inception of RRBs. But for the efforts of NABARD and initiative of sponsor banks besides RRB managements themselves in HR development and in implementation of the reform package, the changes in business performance of RRBs would not have been possible. The work could be accomplished by NABARD working in close tandem with GoI and RBI besides the sponsor banks. NABARD would continue to give special priority to RRBs

to train their staff through the training institutions like the Bankers Institute of Rural Development (BIRD) at Lucknow and the Regional Training Colleges at Mangalore and Bolpur, specially set up for meeting the training requirements of RRBs. NABARD may design suitable training programmes to enable RRBs to meet the challenges in the post merger environment. This training may also cover members of the Board of the RRBs. This support should be provided by NABARD working in close tandem with GoI, RBI and the sponsor banks.

Implementation of RBI initiatives for financial inclusion

5.39 All the recent circulars relating to financial inclusion, viz., no frills accounts, GCC, One Time Settlement (OTS) for loans up to Rs. 25,000, use of intermediaries, etc., should be implemented by RRBs.

Local Area Banks

5.40 The Finance Minister, in his August 1996 Budget, announced the concept of Local Area Banks (LAB) and following this, the RBI issued guidelines and sought applications for setting up LABs. Only 6 LABs were licensed to operate by RBI, of which 4 are currently functioning. Though the overall performance indicators of functioning LABs appear to be healthy, there have been a few instances of LABs having to close down. Keeping in view the inherent potential of LABs, RBI may consider revisiting the same and keep the option open to allow new LABs to come into operation, especially in districts / regions manifesting high levels of exclusion without compromising on regulatory prescriptions. LABs can integrate well with local financial markets and offer a host of financial services including savings, credit, remittances, insurance, etc.

Chapter - 6

Cooperative Credit Institutions

Cooperative Credit Movement over the Years - An Overview

6.01 Rural credit cooperatives in India were originally envisaged as a mechanism for pooling the resources of people with small means and providing them with access to different financial services. Democratic in features, the movement was also an effective instrument for development of degraded waste lands, increasing productivity, providing food security, generating employment opportunities in rural areas and ensuring social and economic justice to the poor and vulnerable.

6.02 The history of the cooperative credit movement in India can be divided in four phases. In the First Phase (1900-30), the Cooperative Societies Act was passed (1904) and “cooperation” became a provincial subject by 1919. The major development during the Second Phase (1930-50) was the pioneering role played by RBI in guiding and supporting the cooperatives. However, even during this phase, signs of sickness in the Indian rural cooperative movement were becoming evident. The 1945 Cooperative Planning Committee had discerned these signs in the movement, finding that a large number of cooperatives were “saddled with the problem of frozen assets because of heavy overdues in repayment.” Even so, also in the Third Phase (1950-90), the way forward was seen to lie in cooperative credit societies. The All India Rural Credit Survey was set up which not only recommended state partnership in terms of equity but also partnership in terms of governance and management. NABARD was also created during this phase. The Fourth Phase from 1990s onwards saw an increasing realization of the disruptive effects of intrusive state patronage and politicisation of the cooperatives, especially financial cooperatives, which resulted in poor governance and management and the consequent impairment of their financial health. A number of Committees were therefore set up to suggest reforms in the sector.

Outreach of the Cooperative Credit Sector

6.03 Of high relevance for financial inclusion of lower income people is especially the Short-term Rural Cooperative Credit Structure (STCCS) providing mainly short and medium-term credit besides other financial services.⁵ At present (March 2005), the three tier STCCS consists, according to statistics of the National Federation of State Cooperative Banks (NAFSCOB), of nearly 1.09 lakh Primary Agricultural Credit Societies (PACS), 368 District Central Cooperative Banks (DCCB) with 12,858 branches and 30 State Cooperative Banks (SCB) with 953 branches or a total of 122,590 service outlets. On an average, there is one PACS for every 6 villages; these societies have a total membership of more than 120 million rural people making it one of the largest rural financial systems in the world.

⁵ The Long-term Cooperative Credit Structure provides mainly long-term agriculture investments loans and consists of 20 State Cooperative Agriculture and Rural Development Banks (SCARDB) and 696 Primary Cooperative Agriculture and Rural Development Banks (PCARDB).

Performance of Rural Cooperative Credit Institutions

Primary Agricultural Credit Societies

6.04 Primary Agricultural Credit Societies, the credit institutions at the grass-root level deal directly with individual members / clients. A large proportion of PACS also serve as outlets for inputs and for the public distribution system for food and other essential items. The total membership of PACS as on 31 March 2005 aggregated to 1,274 lakh, of which, the borrowing members at 451 lakh constituted around 35% (table below). The total as well as borrowing members of PACS declined during 2004-05. Deposits and borrowings of PACS increased by 5 and 17%, respectively, as on 31 March 2005 over the previous year. The loans issued increased by 12% during 2004-05 as compared to an increase of 3.3% during 2003-04, over the previous year.

Particulars (31 March)	PACS		
	2003	2004	2005
No. (lakh)	1.12	1.06	1.09
Members (cr.)	12.36	13.54	12.74
Borrowers (cr.)	6.39	5.13	4.51
Owned funds (Rs. cr.)	8198	8397	9197
Deposits (Rs. cr.)	19120	18143	18976
Borrowings (Rs. cr.)	30278	34257	40429
Loans issued (Rs. cr.)	33996	35119	39212

Source : NAFSCOB

6.05 As per the data available with NAFSCOB, small and marginal farmers constitute nearly 70% of total membership of PACS at the national level, while SCs / STs constitute 34%. Wide regional variations are observed – while Western and Southern Regions have a greater proportion of SFs as members, Eastern and Central Regions have nearly half of their members belonging to SC / ST category.

6.06 The average membership per PACS (all India) is 1,171 persons as shown in the table below. Southern Region has the highest average at 2,986 persons, while Western has the lowest at 441 persons. The average borrowing membership per PACS (all-India) is 414 persons. While the Southern Region has the highest average at 944 persons, North-Eastern Region has only 91 borrowing members, on an average.

6.07 The gap between the average membership and the average borrowing membership can be presumed as the credit potential available. Viewed thus, there is a huge potential for extending credit outreach by the cooperatives, especially in the Southern Region as shown in the table below.

Sr. No.	Region	Total no. of PACS	Total membership (no. '000)	Average membership / PACS	Total borr. membership (no. '000)	Average borr. membership / PACS	Credit potential available (no./ PACS)
1	Central	13723	8322.68	606	6810	496	110
2	Eastern	28928	38952.94	1347	11989	414	933
3	North-Eastern	3628	3835.62	1057	330	91	966
4	Northern	16819	17084.63	1016	7191	428	588
5	Southern	15349	45832.06	2986	14484	944	2042
6	Western	30332	13378.49	441	4266	141	300
	Total	108779	127406.42	1171	45070	414	757

Source : NAFSCOB

6.08 Though the network of commercial banks and RRBs has spread rapidly and they now have nearly 50,000 branches, their reach in the countryside both in terms of the number of clients and accessibility to the small and marginal farmers and other poorer segments is far less than that of cooperatives. In terms of number of agricultural credit accounts, the STCCS has 50% more accounts than the commercial banks and RRBs put together. Directly or indirectly, it covers nearly half of India's total population.

Health of Rural Credit Cooperatives

6.09 Despite the phenomenal outreach and volume of operations, the health of a very large proportion of these rural credit cooperatives has deteriorated significantly. The institutions are beset with problems like low resource base, high dependence on external sources of funding, excessive Governmental control, dual control, huge accumulated losses, imbalances, poor business diversification, low recovery, etc. Around half of the PACS, a fourth of the intermediate tier, viz., the DCCBs, and under a sixth of the State-level apex institutions, viz., the SCBs are loss-making. The accumulated losses of the system aggregate over Rs. 9,100 crore. Non-performing assets (NPA), as a percentage of loans outstanding at the level of SCBs and DCCBs, at the end of March 2006 were around 16% and 20% respectively. These institutions do not, therefore, inspire confidence among their existing and potential members, depositors, borrowers and lenders. Thus, there is a need to find ways for strengthening the cooperative movement and making it a well-managed and vibrant medium to serve the credit needs of rural India, especially the small and marginal farmers.

Need for Revival of the Cooperative Credit Institutions

6.10 Given the above indicators, there has been considerable debate on whether there is an imperative need for revival of these institutions. Herein, it may be pertinent to reiterate the following points :

6.11 In the first place, India is a country with a population of more than 100 crore, of which around 70 crore reside in a little over 6 lakh villages. As there are a little over one lakh PACS in the country, the first fact to be appreciated, therefore, is that every 6th village, on an average, has an existing cooperative credit outlet.

6.12 Secondly, although the rural credit system includes about 45,000 rural and semi urban branches of commercial banks and RRBs, if one would net out the cooperatives from the aggregate rural presence of all RFIs, the per outlet population coverage deteriorates from 1:4,393 to 1:14,893. The short point is that on grounds of outreach, cooperatives cannot be ignored.

6.13 Thirdly, the outreach is significant not merely in absolute numbers but also in terms of location of outlets. The number of PACS located in hilly terrains, deserts and other areas with poor access far exceed the number of rural branches of commercial banks and RRBs.

6.14 The same set of conclusions flow when the system is viewed in the context of its membership. Assuming an artificially low family size of 4, a back of envelope calculation shows that cooperative membership touches the lives of nearly 48 crore rural people which is more than half the aggregate rural population.

6.15 As regards number of agricultural credit accounts, the credit cooperatives have 50% more accounts than scheduled commercial banks (including RRBs). Of these, 70% are estimated to be marginal and sub-marginal farmers.

6.16 On the financial side, it is sometimes argued that in terms of deposits, rural and semi-urban branches of commercial banks have nearly six times more deposits than cooperatives. While this is true, it is also true that this is part of a historic policy infirmity which allowed cooperatives to be treated as “refinance windows” instead of incentivising them into becoming genuine thrift and credit institutions.

6.17 Coming to the assets side of the balance sheet we find that cooperatives have a 37% share in the aggregate crop loans provided by the RFIs. However, in many districts, particularly in remote, hilly and desert areas the share is upwards of 50%.

6.18 Notwithstanding a larger client base, the share of cooperatives in institutional credit is lower than that provided by the commercial banks. This is because the average loan size of cooperatives is smaller at Rs. 6,637 as compared to Rs. 31,585 of commercial banks which also confirms the claim that nearly 70% of the cooperative structure's clients are small and marginal farmers.

6.19 A little known fact is that the system has nearly 64,000 godowns. Given an appropriate policy dispensation entailing private partnership, conditions can be created for holding of crops by farmers at the ground level in these godowns while allowing them to negotiate the godown receipts in the market. A specific plan to revitalize these godowns in cooperative sector be drawn to make them the nerve centres of rural economy on a ‘kiosk’ model providing storage and financial services.

Cooperatives and the Reform Process

6.20 In the backdrop of these credentials, a look has to be taken at the reform process and what it means to the cooperative credit institutions. The financial sector reforms have been components of the overall economic reforms undertaken in a phased manner from 1991-92 by GoI. These reforms also envisaged improving the efficiency and productivity of the rural credit delivery system which in turn would accelerate the requisite credit flow to the productive sectors of the economy.

6.21 The major objectives of these reforms in the cooperative sector were :

- To make the institutions competitive by removing external constraints having a bearing on their operations,
- To improve their financial health,
- To ensure transparency in their business operations,
- To improve their profitability, *and*
- Institutional building and strengthening.

6.22 According to the Task Force on Revival of Rural Cooperative Credit Institutions (Vaidyanathan Committee), the STCCS never realized the enormous potential opened up by its vast outreach owing mainly to a “deep impairment of governance”. While they were originally visualized as member-driven, democratic, self-governing, self-reliant institutions, cooperatives have, over the years, constantly looked up to the State for several basic functions. The Task Force has described in detail how the State Governments have become the dominant shareholders, managers, regulators, supervisors and auditors of the STCCS. The concept of mutuality (with savings and credit functions going together), that provided strength to cooperatives all over the world, has been missing in India. This “borrower-driven” system is beset with conflict of interest and has led to regulatory arbitrage, recurrent losses, deposit erosion, poor portfolio quality and a loss of competitive edge for the cooperatives. The Task Force Report also recognised that there is an impasse in the laws governing

cooperative banking institutions in the country as cooperation is a State subject while banking activities are regulated by a Central Act. Further, the Task Force also took cognizance of the poor quality of internal control systems, house keeping and audit in addition to professionally not qualified human resources manning the CCS.

6.23 For the revival of the STCCS, the Vaidyanathan Committee Report has suggested an implementable Action Plan with substantial financial assistance for recapitalisation subject to introduction of strict legal and institutional reforms together with technical assistance for human resource development (HRD), establishment of a common accounting system and computerisation. The implementation of the Revival Package would result in the emergence of strong and robust cooperatives with conducive legal and institutional environment for it to prosper. At the macro level, the Revival Package is expected to promote growth with social justice and greater financial inclusion. In this background, the following observations are noteworthy :

- With 127 million plus membership and 45 million plus borrowing membership, the STCCS already exceeds the combined client base of commercial banks and RRBs. With nearly 1.25 lakh outlets spread throughout the length and breadth of the country, the STCCS after implementation of the recommendations of the Vaidyanathan Committee would be adequately equipped and would be a highly appropriate mechanism to promote financial inclusion.
- Located in rural areas, governed by local community leadership and managed by the staff with roots in rural areas, the STCCS would be oriented for promoting financial inclusion more effectively.
- The CCS with large membership of small and marginal farmers would have necessary ethos to promote and encourage financial inclusion of deprived sections of the rural economy.
- With limited overheads, the CCS outlets will be an appropriate medium for encouraging financial inclusion through “no frills” savings accounts etc.
- The rural populace will be more comfortable and will easily identify culturally with the STCCS.
- Payments under various social welfare schemes of Central and State Governments for instance old age pension, Employment Guarantee Scheme (EGS), scholarships for students, etc. could be made more transparent, safe and foolproof if routed through the STCCS and the recipients could receive the assistance at their doorsteps.
- As envisaged in the Vaidyanathan Committee Report, the membership of PACS should be open to all members of the village without any restrictions. For the purpose, the existing restrictions regarding land holding etc., should be done away with. If need be, PACS could be rechristened as Primary All-purpose Credit Societies instead of Primary Agriculture Credit Societies.
- The STCCS would be an ideal instrument for promoting financial inclusion through SHGs. Many cooperatives could be transformed into SHPIs with proper sensitisation. Promotion of SHGs could, indeed, become a major component of the Business Development Plan of cooperative organisations of the STCCS.
- As the Vaidyanathan Committee is envisaging application of IT right from PACS to SCBs, the STCCS would be in a position to cope with the additional work load on account of promoting financial inclusion. This, in fact, would go a long way in improving the productivity of the credit cooperatives. With due internal controls and checks in place, PACS could ideally be developed as BCs of

DCCBs as well as for commercial banks / RRBs wherever the reform process facilitates this.

- As financial inclusion also envisages delivery of financial services at an affordable cost, the STCCS being accessible at the door step of the financially excluded sections of the society will be in a better position to render these services more effectively.
- Located in the rural areas, the STCCS units will have better knowledge of their existing and potential clients and, as such, KYC will not be a major hindrance.

Role Envisaged for Cooperatives in the Planning Process

6.24 The cooperative credit institutions are being called upon for a greater involvement in credit dispensation during successive Five Year Plans. The Working Group on Agricultural Credit, set up by the Planning Commission, for the formulation of the X Five Year Plan, had made a projection of credit flow for agriculture at Rs. 736,000 crore at 4% growth rate in agriculture GDP. Of this, the cooperative credit structure alone was required to provide during the plan period Rs. 271,000 crore from Rs.24,000 crore during the first year (2002-03) of the X Five Year Plan, on the assumption that it would maintain its share of at least 42% in the total credit purveyed. During the period 2003-04 to 2006-07, these institutions, put together, have purveyed credit to the tune of Rs. 136,229 crore for agriculture and allied activities.

Impact Envisaged Post Implementation of the Recommendations of the Task Force

6.25 The Committee concurs with the Vaidyanathan Committee's view that cooperatives are heterogeneous and exhibit wide variations in terms of method of operations, quality of governance, working results, etc. The Committee also notes that in certain areas, cooperatives have done exceedingly well. It is expected that with the implementation of the reform package as envisaged by the Vaidyanathan Committee (already 13 States have signed the MoU with GoI and NABARD, while another 5 States and 1 UT have indicated their "in principle" acceptance), the cooperatives will be able to emerge stronger.

6.26 Consequent on implementation of the Revival Package, there will be two sets of outcomes – one at the sector level and the other at the macro level. At the sector level the legal environment within which the sector functions will become more enabling and there will be institutional upgradation in terms of systems and procedures, HRD, technology, etc. This will improve the internal operational efficiency of the system leading to more robust fundamentals.

6.27 At the macro level, this process will complete the financial sector agenda in regard to capitalization of impaired entities. India embarked on its reforms in the financial sector in 1992 with the capitalization of commercial banks followed by that of RRBs. Capitalisation of the rural cooperative credit structure will bring this process to a logical completion.

6.28 The other area of impact would be on the national goal of growth with equity. As already indicated, nearly 70% of the membership of the rural credit cooperatives are small and marginal farmers. As cooperative institutions improve their health and methods of operation, the number of borrowing members as a percentage of total membership will increase, thus bringing larger number of small and marginal farmers within the cooperative fold. This will help in addressing the credit requirements of

this segment of the rural population which is sometimes bypassed in the growth process. This is an important outcome in regard to financial inclusion.

Emerging Role of Cooperatives in Microfinance

6.29 The Andhra Pradesh Mutually Aided Cooperative Societies (APMACS) Act, 1995 has resulted in the creation of over 30,000 new Mutually Aided Cooperative Societies (MACS) in Andhra Pradesh. A vast majority of these are Village Organisations (VOs) of SHGs and about 800 are higher level federations of these VOs at the Mandal level (20-30 villages). All these have been formed as part of the Velugu Programme. However, about 600 MACS are independent of the Velugu Programme, and have been promoted by NGOs. These institutions are able to provide savings and credit services to their members and are fully autonomous.

6.30 The parallel Acts are also one way to federate SHGs and form community based MFIs. The founding NGO only plays a facilitating role and there are no external shareholders.

Keeping in view what has been discussed above, the Committee makes the following **recommendations** in regard to the cooperative credit institutions :

Early Implementation of Vaidyanathan Committee Revival Package

6.31 The Committee is in broad agreement with the recommendations of the Vaidyanathan Committee and suggests that all necessary steps should be taken for the early implementation of the STCCS revival package in all States. Consequent on the implementation of the Vaidyanathan Committee recommendations, the Committee hopes for the emergence of a more robust, well managed and self-reliant cooperative credit system with improved governance structures and technology applications.

Cooperatives in SHG Linkage – Need for enabling legislations

6.32 The Committee is of the view that cooperatives are a good forum for enabling financial inclusion through SHGs. This has been demonstrated in several districts such as Bidar in Karnataka, Chandrapur in Maharashtra and Mandsaur in Madhya Pradesh. The Committee notes that in certain States, legislation has been enacted, admitting SHGs as members of PACS and recommends the enactment of similar legislation in other States to enable the emergence of cooperatives as effective SHPIs. The Committee also recommends that federations of SHGs may be registered in all the States under the Cooperative Societies Act or the parallel Self Reliant Cooperatives Act and availability of funds to these cooperatives for advancing loans may be considered by NABARD, based on objective rating criteria. NABARD may also set aside requisite funds for sensitising the cooperative movement in this regard.

Use of PACS and other Primary Cooperatives as Business Correspondents

6.33 There are a large number of PACS and primary cooperatives under the parallel Acts located in rural areas where there are no other financial services outlets. Many of these cooperatives are in districts where the DCCBs are defunct or moribund. Such PACS could provide valuable services to their members if they get access to a commercial bank. These PACS could originate credit proposals, disburse loans, collect repayments and even collect savings on behalf of the commercial bank. They could also act as payment channels. RBI has already listed Cooperatives as eligible institutions under the BF/BC Model.

6.34 In the circumstances, the Committee recommends that the Cooperatives may make use of this opportunity atleast in States which have accepted the Vaidyanathan Committee recommendations. NABARD may be asked to suggest appropriate guidelines for the purpose, subject to the approval of RBI.

Cooperatives Adopting Group Approach for Financing Excluded Groups

6.35 Micro-enterprises, in order to be successful, require larger funding which NGOs cannot provide. It will, therefore, be necessary to develop / test a new form of community based organisation other than SHGs which may be more appropriate to support members who engage in micro-enterprises. Those members of SHG who opt to graduate to micro-enterprises could be formed into JLGs or some similar organisation.

6.36 Banks may be more inclined to lend to individuals in this group based on the performance of each member in the SHG as well as on the assumption that a JLG will provide some degree of mutual guarantee. There is evidence however, that the relations of mutual trust and support which is described as affinity in a SHG tend to be weaker in a JLG. Therefore, new forms of collateral or guarantee may have to be worked out. In this regard, NABARD has already circulated the guidelines which may be adopted by banks.

6.37 Further, the use of the BF model could be thought of to organize vulnerable segments of the population into JLGs. The pilot project presently under implementation by NABARD should be sufficiently broad based to cover the role of facilitators in formation and linkage of JLGs.

Risk Mitigation - setting up of Credit Guarantee Fund

6.38 The Committee also recommends the setting up of a Credit Guarantee Fund as a risk mitigation mechanism and also for providing comfort to the banks for lending to such JLGs (akin to the Credit Guarantee Fund Scheme for Small Industries - CGFSI - available for small-scale industries - SSI - at present).

Chapter – 7

Self Help Group – Bank Linkage Model

Introduction

7.01 The SHG - Bank Linkage Programme is a major plank of the strategy for delivering financial services to the poor in a sustainable manner. The search for such alternatives started with internal introspection regarding the innovations which the poor had been traditionally making, to meet their financial services needs. It was observed that the poor tended to come together in a variety of informal ways for pooling their savings and dispensing small and unsecured loans at varying costs to group members on the basis of need.

7.02 The SHG – Bank Linkage Programme was started as an Action Research Project in 1989 which was the offshoot of a NABARD initiative during 1987 through sanctioning Rs. 10 lakh to MYRADA as seed money assistance for experimenting Credit Management Groups. In the same year the Ministry of Rural Development provided PRADAN with support to establish self-help groups in Rajasthan.

7.03 The experiences of these early efforts led to the approval of a pilot project by NABARD in 1992. The pilot project was designed as a partnership model between three agencies, viz., the SHGs, banks and NGOs. This was reviewed by a working group in 1995 that led to the evolution of a streamlined set of RBI approved guidelines to banks to enable SHGs to open bank accounts, based on a simple “inter se” agreement. This was coupled with a commitment by NABARD to provide refinance and promotional support to banks for the SHG - Bank Linkage Programme.

7.04 Initially there was a slow progress in the programme up to 1999 as only 32,995 groups were credit linked during the period 1992 to 1999. Since then the programme has been growing rapidly and the number of SHGs financed increased from 81,780 in 1999-2000 to more than 6.20 lakh in 2005-06 and 6.87 lakh in 2006-07 (table below).

Year	No. of SHGs financed during the year (in lakh)	Cumulative no. of SHGs financed (in lakh)
2001-02	1.98	4.61
2002-03	2.56	7.17
2003-04	3.62	10.79
2004-05	5.39	16.18
2005-06	6.20	22.38
2006-07	6.87	29.25

7.05 NABARD, in association with GTZ, conducted a study, in 2005, on the comparative performance of SHG – Bank Linkage Programme vis-à-vis other priority sector credit. The findings are based on the data received from 27 commercial banks, 192 RRBs and 114 cooperative banks participating in the programme. One of the important observations of the study was that 1.44 million SHGs had loans outstanding of Rs. 4,200 crore with the banking system. 2.63 million SHGs had saving accounts with the banks and the savings outstanding was Rs. 2,391 crore.

7.06 To cover all the 50 million odd poor households in India, the existing number of SHGs will have to be more than doubled and the extent of credit to the members of each SHG will have to be increased substantially.

Positive Features of the SHG - Bank Linkage Programme

7.07 The financial inclusion attained through SHGs is sustainable and scalable on account of its various positive features. The programme confronts many challenges and for further scaling up, these challenges need to be addressed.

Financial Inclusion of Poor Women

7.08 The Committee noted that more than 90% of the members of SHGs are women and most of them are poor and assetless. The SHG movement has been instrumental in mainstreaming women by-passed by the banking system.

Loan Repayments

7.09 One of the distinctive features of the SHG - Bank Linkage Programme has been very high on-time recovery. As on June 2005, the on-time recovery under SHG - Bank Linkage Programme was 90% in commercial banks, 87% in RRBs and 86% in cooperative banks.

Programme Impact

7.10 The major findings and recommendations of three studies on the impact of the SHG - Bank Linkage Programme are summarised in Annexure III.

7.11 The main findings reveal that the programme has :

- Reduced the incidence of poverty through increase in income, and also enabled the poor to build assets and thereby reduce their vulnerability.
- Enabled households that have access to it to spend more on education than non-client households. Families participating in the programme have reported better school attendance and lower drop out rates.
- Empowered women by enhancing their contribution to household income, increasing the value of their assets and generally by giving them better control over decisions that affect their lives.
- Reduced child mortality, improved maternal health and the ability of the poor to combat disease through better nutrition, housing and health - especially among women and children.
- Contributed to a reduced dependency on informal money lenders and other non-institutional sources.
- Facilitated significant research into the provision of financial services for the poor and helped in building “capacity” at the SHG level.
- Finally, it has offered space for different stakeholders to innovate, learn and replicate. As a result, some NGOs have added micro-insurance products to their portfolios, a couple of SHG federations have experimented with undertaking livelihood activities and grain banks have been successfully built into the SHG model in the Eastern Region. SHGs in some areas have employed local accountants for keeping their books, and IT applications are now being explored by almost all for better management information systems (MIS), accounting and internal controls.

Challenges

Group Loans to SHGs and SHG Loans to Members

7.12 The average loan provided to SHGs by the banks for the last three years is presented in the following table :

Year	No. of SHGs financed		Bank loan (Rs. crore)		Per group loan (Rs.)	
	New	Existing	New	Existing	New	Existing
2003-04	361731	171669	1157.74	697.74	32005	40644
2004-05	539365	258092	1726.60	1267.60	32012	49114
2005-06	620109	344502	2330.45	2168.63	37581	62949

7.13 During the year 2005-06, the average loan provided to new SHGs was Rs. 37,581. On an average, per member loans work out to less than Rs. 4,000. Many believe that such loan amounts are grossly inadequate for pursuing any meaningful livelihood activity. Per capita loans in mature SHGs are increasing very gradually. It has also to be kept in view that members take very short term loans of 3 to 6 months on many occasions and there can be more than one cycle of borrowing/ repayment in one year.

Cost Recovery and Sustainability

7.14 It is important for banks to carefully work out their actual costs for SHG lending. While the SHG portfolio is often only a small part of the total bank lending, and since the portfolio quality is good, it may be possible to reduce interest rates while ensuring recovery of costs.

7.15 In the initial phase of the SHG movement, the groups were formed by NGOs and hence start-up costs were low for banks. However, over the years, banks have also evolved as SHPIs. In the process, the start-up costs of group formation, etc. have devolved on the banks, impacting their pricing policies.

7.16 It is an accepted fact that banks will base their lending rate decisions on three important criteria – their cost of funds, transaction costs and the required spreads. While the sources of funds will determine the cost of funds, the transaction costs will depend mostly on the efficiency with which the transfer of funds is enabled. Banks need to recognize the cost elements involved in the decision-making process while approving credit linkage and in maintaining the accounts of the group, throughout the repayment period. Considering the small value of loans purveyed to groups, the rate of interest charged will also be in the lower slabs, thereby earning on thinly spread margins. The other major component of costs, viz., risk costs, is intrinsically low in SHG lending and, therefore, could play a limited role in pricing of credit products for SHGs. In this regard, the Committee perused the analysis made by the RBI on cost of transactions for small accounts. The same is indicated in Annexure IV.

7.17 Further, there is an element of indirect subsidy as presently NABARD supports the costs involved in formation and nurturing of SHGs up to the stage of credit linkage. This financial support is around Rs. 3,000 per SHG. The Ministry of Rural Development (MoRD) has established a norm of Rs. 10,000 per group for the Swarnajayanti Gram Swarajgar Yojana (SGSY) Programme, payable over four phases. If an additional one million SHGs have to be formed, the fund support would amount to nearly Rs. 1,000 crore, going by the MoRD norms. Accordingly, the Committee is of the view that the existing dispensation of subsidy in the form of a

revolving fund initially and as capital subsidy for income generating activities in the second stage may not be sustainable with the exponential growth recently observed in the formation of groups under the programme.

7.18 At present, banks do not incur incremental costs for lending to SHGs, as it is done through the existing branch network. SHG lending to members has been reportedly at interest rates ranging between 15% and 24%. While this has been considered high, it is also reported that members borrow for short periods and do not feel the annualized burden of interest rates. Further, the interest income of SHGs is ploughed back into the corpus for lending and is beneficial to all members.

Regional Imbalances

7.19 The spread of the SHG - Bank Linkage Programme in different regions has been uneven on account of various factors like pro-active role of State Governments, presence of well performing NGOs, socio-cultural factors, better performance of SHGs, etc. In March, 2001, 71% of the linked SHGs were from Southern Region consisting of Andhra Pradesh, Karnataka, Kerala and Tamil Nadu. The share of Southern Region has come down progressively over the years but it is still at 44%. Many States such as Uttar Pradesh and Bihar with high incidence of poverty have shown poor performance under the programme.

7.20 One of the major concerns was the slow progress of the SHG Bank Linkage movement in the north-eastern and central parts of the country. It was even argued in some quarters that the SHG strategy was not suitable to the social configurations that prevailed in the north-east. As a result of the special efforts made by NABARD, progress in the Regions / States where imbalances and low performance had been observed has picked up considerably, as detailed in the following table :

Region / State	Development of cumulative nos. of SHGs financed					
	March 2001	March 2002	March 2003	March 2004	March 2005	March 2006
NE Region	477	1,490	4,069	12,278	34,238	62,517
KBK Region	4,192	9,869	18,934	31,372	45,976	64,550
Orissa	8,888	20,553	42,272	77,588	123,256	180,896
West Bengal	8,739	17,143	32,647	51,685	92,698	136,251
Bihar	4,592	3,957	8,161	16,246	28,015	48,138
Jharkhand	0*	4,198	7,765	12,647	21,531	28,902
Uttar Pradesh	23,152	33,114	53,696	79,210	119,648	163,439
Uttaranchal	0*	3,323	5,853	10,908	14,043	16,060
Rajasthan	5,616	12,564	22,742	33,846	60,006	98,171
Himachal Pradesh	2,545	5,069	8,875	13,228	17,798	22,920
Madhya Pradesh	5,699	7,981	15,271	27,095	45,105	58,912
Chattisgarh	0*	3,763	6,763	9,796	18,569	29,504
Maharashtra	10,468	19,619	28,065	38,535	71,146	131,470
Gujarat	4,929	9,496	13,875	15,974	24,712	34,160
All India	263,825	461,478	717,360	1,079,091	1,618,456	2,238,565

NE = North-East, KBK = Kalahandi-Bolangir-Koraput * included in the undivided State Source : NABARD

Monitoring, Capacity-building and Synergy Issues

7.21 The general reports on the progress of SHGs show statistics of growth and spread of SHGs without providing details on the development process and internal health of SHGs. The system for monitoring of SHGs and compiling data on the health

indicators need to be built up in order to ensure long term sustainability of the groups. There could be a separate SHG Monitoring Cell in every State promoted by the State Government in cooperation with other stakeholders.

7.22 Currently, the major emphasis of capacity building efforts is on bankers, NGOs and government officials involved in promoting and financing SHGs. Since many of the SHGs are maturing and their business level has increased substantially, the focus should shift to capacity building of SHG members so that the accounts keeping, auditing and credit management at the group level improves.

7.23 There are a few Government sponsored programmes, particularly the SGSY, that are also using the group approach for addressing poverty alleviation. The main objective of the SGSY is to organize the identified families into groups and assist them in coming out of poverty by providing them income generating assets through a mix of bank loan and government subsidy. It covers all aspects of self-employment of the rural poor, viz., organisation of the poor into groups and their capacity building, training, selection of key activities, planning of activity clusters, infrastructure build-up, technology and marketing support.

7.24 The programme has some positive features such as (i) per capita loans to SGSY group members for undertaking economic activities is much higher than under the SHG - Bank Linkage Programme; and (ii) there is a good coverage of SC / ST and disabled persons. The success of the SHG-Bank linkage programme has motivated the Government to borrow its design features and incorporate them in their poverty alleviation programme. This is certainly welcome but for the fact that the SGSY has an inbuilt subsidy element which tends to attract linkage group members and cause migration generally for the wrong reasons. Also, micro level studies have raised concerns regarding the process through which groups are formed under the SGSY and have commented that in many cases members are induced to come together not for self help, but for subsidy. Therefore, there is a need to bring better synergy between SGSY groups and the SHGs of the linkage programme which are premised on savings.

Joint Liability Groups

7.25 SHGs are now emerging as an effective credit delivery channel for mid-segment clients such as share croppers and tenant farmers as their loan requirements are much larger. For developing an effective model for this group, NABARD had introduced a pilot project for formation and linking of JLGs.

7.26 A JLG is an informal group comprising 4 to 10 individuals coming together for the purposes of availing bank loan either singly or through the group mechanism against mutual guarantee. The JLG members are expected to engage in similar type of economic activities like crop production. Under the Scheme, tenant farmers cultivating land either as oral lessees or sharecroppers and small farmers who do not have proper title of their land holding will be eligible for collateral-free credit through formation and financing of JLGs. Towards ensuring greater inclusion of these vulnerable groups, all the members of the JLG, which is intended primarily to be a credit group, will be encouraged to open individual “no frills” account. NABARD had piloted the project for formation and linking of JLGs during 2004-05 in 8 States of the country through 13 RRBs through the mechanism of joint liability approach. During the year 285 JLGs with bank finance of Rs. 4.48 crore were promoted. During 2005-06, banks disbursed Rs. 6.79 crore to 488 JLGs.

7.27 Based on the considerations indicated above, the Committee makes the following **recommendations** for deepening microfinance interventions and making it an effective tool in achieving greater inclusion :

Encouraging SHGs in Excluded Regions – Funding support

7.28 In order to further increase efforts in addressing regional imbalances, there is a need to involve State Governments. In some States, the programme is driven mainly through NGOs and other SHPIs like banks, farmers' clubs, individual rural volunteers, etc. The Committee is of the view that if the programme is to reach a critical scale, the Department of Women and Child Development at the State-level should be actively involved in promoting and nurturing of SHGs. The State Govts. and NABARD may, therefore, set aside specific funds out of the budgetary support and the Micro Finance Development and Equity Fund (MFDEF) respectively for the purpose of promoting SHGs in regions with high levels of exclusion.

7.29 The spread of SHGs in hilly regions, particularly in the North-Eastern Region, is poor. One of the reasons for this is that the population density in hilly areas is often low and the banking network is weak. There is a need to evolve SHG models suited to the local context of such areas.

Capacity building of Government functionaries

7.30 Certain deficiencies in the involvement of Government Departments have been brought to the Committee's notice, including poor follow up, ineffective monitoring and inadequate training and capacity building efforts which have, in turn, diluted the quality of programme implementation. The Committee is, therefore, of the view that adequate safeguards may be devised and built in future programme implementation strategies. NABARD can also facilitate this process by providing support for capacity building of Government functionaries from grass root level upwards within the SHG framework.

Legal Status for SHGs

7.31 As of now, SHGs are operating as thrift and credit groups. They may, in future, evolve to a higher level of commercial enterprise. The question of providing a simplified legal status to the SHGs may have to be examined in full, in this context. This would also facilitate their becoming members of PACS.

Maintenance of participatory character of SHG movement

7.32 A movement of such large scale involving people's participation could lead to attempts towards politicization. This must be avoided. Sufficient care has to be taken to ensure that the SHG movement retains its participatory and self-help character.

NABARD to open 'Project Offices' in identified Priority States

7.33 The Committee further notes that NABARD is managing the MFDEF with a corpus of Rs. 200 crore. One of the major focus of the fund should be promoting the SHG-Bank Linkage Programme in States where it has been comparatively slow moving. NABARD has already identified 13 States with large population of the poor, but exhibiting low performance in implementation of the programme. The ongoing efforts of NABARD to upscale the programme in the identified States need to be given a fresh impetus.

7.34 In this context, it is recommended that NABARD can open dedicated project offices in the 13 States for upscaling the SHG - Bank Linkage Programme by

strategizing interventions such as stronger involvement of State Governments, capacity building of NGOs, broadening the range of SHPI, etc.

Incentive package for NGOs

7.35 Many of the NGOs have played a commendable role in promoting SHGs and linking them with banks. NGOs, being local initiators with their low resources are finding it difficult to expand in other areas and regions. There is, therefore, a need to evolve an incentive package which should motivate these NGOs to diversify into other backward areas. Incentive package could be in the form of expeditious and hassle-free grant support.

RBI/NABARD to study the issue of ‘evergreening’

7.36 It was also noted by the Committee that a certain element of “evergreening” of loans is taking place among credit linked SHGs. This, if established, is a matter of concern. The Committee advises RBI/ NABARD to expeditiously study this aspect and come out with suggestions for reversing this unsettling trend.

Transparency in maintenance of records

7.37 In order to ensure sustainability of the SHGs, their activities and linkages, the Committee recommends that there should be better transparency in the books of accounts maintained at the group level. These books should reflect the position of deposits in members’ accounts, interest paid on savings, distribution of corpus or operating surplus among members, evergreening of loan accounts, etc. The Committee also recommends that the banks, with the help of NABARD, should evolve a checklist for concurrent monitoring of SHGs.

SHGs to evolve norms for distribution of surplus

7.38 Many of the SHGs do not have the practice of distributing the surplus generated from their business activities within the group and the awareness on this issue among the SHG members is very low. The Committee recommends that there is a need to evolve norms for distribution of surplus (akin to dividend) especially at the time when a member drops out of the group.

Need to restructure design & direction of SGSY subsidy

7.39 It is recommended that subsidies provided under SGSY are restructured. Various studies, conducted by the National Institute of Bank Management (NIBM) and National Institute of Rural Development (NIRD), point out that linking credit with subsidy is not an effective approach for reaching out to the poor. The Committee is of the view that there is a need to formulate a single programme synergising the positive features of SGSY such as specific targeting of below poverty line (BPL) families, etc. and those of the SHG – Bank Linkage Programme such as group cohesiveness, discipline, etc.

7.40 While recognizing that individual subsidies are distortionary, the Committee recommends that the Government may consider redirecting subsidy in the SGSY Programme for the following purposes:

- Capacity building of NGOs and other field based agencies such as Krishi Vigyan Kendras, to form and strengthen SHGs.
- Exposure visits to successful models by bankers, government officials and SHG leaders etc.
- For strengthening input supply and marketing arrangements.

7.41 Some of the State Governments like West Bengal and Andhra Pradesh have initiated efforts in this direction. Further, it is understood that the proposals are awaiting approval of the GoI. The Committee recommends that the approaches adopted by these States for bringing synergy between SGSY groups and the SHGs of the linkage programme can be studied so that the same can be replicated in other States. The broad features of the proposed convergence model are indicated in Annexure V.

7.42 The need for technology adoption for effective disbursement of Govt. subsidy should be recognized. The existing dispensation of subsidy under SGSY and payouts under NREGP could be routed thru' bank accounts, with suitable technology support.

Interest rate subsidy

7.43 It has been brought to the notice of the Committee that certain States are providing a subsidy on interest rates being charged by banks to the SHGs. While the average rate of interest on banks' lending to SHGs is around 12%, most SHGs charge interest rates of around 22%-24% to members. The margin available to SHGs is, thus, sufficient to take care of operational costs, even after considering the small amounts of loan provided to members. The Committee is of the opinion that a subsidy on interest rates cuts at the very root of the self help character of SHGs. As already indicated, the subsidy could be re-directed towards capacity building efforts or in providing input supplies and marketing support to the SHGs.

Resource Centres

7.44 For ensuring the long term sustainability of SHGs and for helping the members of mature SHGs to graduate from microfinance to micro-enterprises, it is proposed that resource centres on the lines of the Andhra Pradesh Mahila Abhivruddhi Society (APMAS) can be set up in different parts of the country.

7.45 The SHG - Bank Linkage Programme is now more than 15 years old. There are a large number of SHGs in the country which are well established in their savings and credit operations. The members of such groups want to expand and diversify their activities with a view to attain economies of scale. Many of the groups are organising themselves into federations and other higher level structures. To achieve this effectively, resource centres can play a vital role.

7.46 Resource centres can be set up by various stakeholders such as NGOs, banks, Government departments, NABARD at the State/ district level to play an important role in preparing training modules, developing a cadre of trainers, conduct of field studies and in promoting interface between SHG members and service providers. The specific role of Resource Centres would be to :

- Work towards a comprehensive capacity building of SHGs,
- Share innovative ideas and models that can be replicated elsewhere,
- Enhance functional literacy among SHG members,
- Support livelihood interventions among SHG members,
- Facilitate availability of all services to SHG members under one roof.

7.47 The committee recommends that the cost for setting up Resource Centres can be met out of the Financial Inclusion Fund and/ or the MFDEF.

SHGs to provide alternative savings products

7.48 One of the distinguishing features of the SHGs is that it is a savings-led model providing opportunities to its members to pool their small savings within the group. Most of the SHGs encourage compulsory savings with equal small amounts by members on a regular basis. SHGs need to offer a wide range of savings products so as to capture the huge potential of savings that remains untapped. Groups should be free to design savings products suiting to members' requirements. Certain level of experimentation could be attempted by the Resource Centres in designing new saving products and NABARD should encourage and support such experiments.

Adoption of JLG Model to cover marginalized groups

7.49 Based on the encouraging experience gained in implementation of the pilot project, a scheme for financing JLGs of tenant farmers and oral lessees has been evolved by NABARD for implementation by all the commercial banks, RRBs and cooperatives. The committee recommends adoption of the concept of JLGs which, if properly grounded, could be another effective method for purveying credit to mid-segment clients such as small farmers, marginal farmers, tenant farmers, etc. and thereby reduce their dependence on informal sources of credit.

From Microcredit to Microenterprise - Challenges

7.50 The present challenge is to induce SHGs and their members to graduate into matured levels of enterprise, factor in livelihood diversification, increase their access to the supply chain, linkages to the capital market and appropriate production and processing technologies.

7.51 A spin off of this challenge is how to address the investment capital requirements of matured SHGs, which have initially met members' consumption needs and are now on the threshold of taking off into "enterprise". There is evidence in MYRADA experience where lending for productive purposes has already been given greater emphasis by SHGs. The Community Managed Resource Centres (CMRCs) organized by MYRADA provide a variety of linkage services to SHGs and individual entrepreneurs among SHG members. This model requires to be studied. The SHG - Bank Linkage Programme needs to introspect whether it is sufficient for SHGs to only meet the financial needs of their members, or whether there is also a further obligation on their part to meet the non-financial requirements necessary for setting up business and enterprises. Ideally, it must meet both.

Greater role for NABARD

7.52 The Committee is of the view that while greater emphasis is needed for growth and spread of SHGs across the country, the quality in terms of outreach of financial services, capacity building, sustainability etc., needs to be reemphasized. NABARD shall play a pro-active role and identify new initiatives that will contribute to effectively improving outreach to the poor thru' SHGs, MFIs, etc.

Federations

7.53 Federations of SHGs at village and taluk levels have certain advantages. However, the disadvantage is that banks lose their direct contact with SHGs if federations act as intermediaries between the financing banks and SHGs. Further, federations may become intrusive, thereby diluting the democratic features of SHG operations. A few models of Federations have been studied by the Committee and

their basic features are indicated in the Annexure VI. A review of the various models is included as Annexure VII.

7.54 The Committee is of the view that federations, if they emerge voluntarily from amongst SHGs, can be encouraged. However, the Committee feels that they cannot be entrusted with the financial intermediation function. In Andhra Pradesh, federations are registered as societies under the MACS Act. The SHG members (as individuals) are permitted to be members in the federation. In Uttarakhand, SHGs are permitted to become members of PACS directly. States may adopt similar enabling legislation.

7.55 The Committee recommends that the voluntary establishment of federations could be supported out of the Financial Inclusion Fund and the MFDEF. While extending support, it should be ensured that federations :

- emerge voluntarily, on the felt need of the SHGs,
- provide other value added services to member SHGs. Based on a study of Federations operating across the country, a broad list of such services and the modus operandi of federations in providing such services can be prepared and circulated by NABARD.
- in terms of distance, operate in close proximity to members.

Urban Microfinance

7.56 There are no clear estimates of the number of people in urban areas with no access to organized financial services. This may be attributed, in part at least, to the migratory nature of the urban poor, comprising mostly of migrants from the rural areas. Even money lenders often shy away from lending to urban poor.

7.57 There have been a few instances of MFIs venturing into this area of lending to urban poor who are undertaking micro-enterprises and small business activities. Urban branches of banks, even though having manpower and technology support, are not attuned to SHG lending or microfinance. They are busy with multiple and diversified activities and generally find no time to cater to the microfinance market segment. Lending opportunities in other sectors dissuade them from attempting the laborious task of microlending. The migratory nature of parts of the low income urban population is also contributing that urban bankers are not venturing into this field.

7.58 Opening of specialised microfinance branches / cells in potential urban centers exclusively catering for microfinance and SHG - bank linkages could be thought of, to address the requirements of the urban poor. BFs / BCs could be the mechanism to reach the target clientele in these areas. However, banks need to implement proper risk management practices, develop suitable models and products tailor-made to this segment. Banks can also consider associating with MFIs undertaking urban microlending as a viable option.

Amendment to NABARD Act

7.59 At present, NABARD is permitted, as per its Act and Mandate, to support micro finance activities in rural and semi-urban areas only. Considering the levels of exclusion prevalent among the urban poor, the unique nature of difficulties faced by them in accessing institutionalized banking services and with a view to leveraging the expertise of NABARD in microfinance, the Committee recommends that an enabling provision be made in the NABARD Act, 1981 permitting NABARD to provide micro finance services to the urban poor.

Chapter – 8

Micro Finance Institutions

Introduction

8.01 MFIs could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele.

8.02 There are several legal forms of MFIs. However, firm data regarding the number of MFIs operating under different forms is not available. It is roughly estimated that there are about 1,000 NGO-MFIs and more than 20 Company MFIs. Further, in Andhra Pradesh, nearly 30,000 cooperative organizations are engaged in MF activities. However, the company MFIs are major players accounting for over 80% of the microfinance loan portfolio. An attempt is made in the following table to capture the various forms of MFIs :

Type of entity	Non-profit	Mutual benefit	For-profit
Association	Society under Societies Registration Act 1860	Cooperative which can be just a savings and credit cooperative or be further licensed as cooperative bank.	Association of persons
Trust under Indian Trusts Act 1920	Charitable trust	Mutual benefit trust	Investment trusts
Company under Indian Companies Act, 1956	Section 25 Company	Mutual Benefit (Sec 620A Nidhi Company)	Company which is further either an NBFC or a bank

Definition of Microfinance and MFIs

8.03 The proposed Microfinance Services Regulation Bill defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for :

- i. an amount, not exceeding rupees fifty thousand in aggregate per individual, for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual) or
- ii. an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing purposes, or
- iii. such other amounts, for any of the purposes mentioned at items (i) and (ii) above or other purposes, as may be prescribed.”

8.04 The proposed regulations further define an MFI as “an organisation or association of individuals including the following if it is established for the purpose of carrying on the business of extending microfinance services :

- i. a society registered under the Societies Registration Act, 1860,

- ii. a trust created under the Indian Trust Act, 1880 or public trust registered under any State enactment governing trust or public, religious or charitable purposes,
- iii. a cooperative society / mutual benefit society / mutually aided society registered under any State enactment relating to such societies or any multi-state cooperative society registered under the Multi State Cooperative Societies Act, 2002 but not including :
 - ❖ a cooperative bank as defined in clause (cci) of section 5 of the Banking Regulation Act, 1949 or
 - ❖ a cooperative society engaged in agricultural operations or industrial activity or purchase or sale of any goods and services.”

Recommendations

8.05 Greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but could eventually enable MFIs to take and use savings as a low cost source for on-lending.

8.06 The Committee examined the structure and nature of operations of MFIs and took into account the proposed provisions of the MFI legislation which is under consideration of the GoI. Keeping in view the above aspects, the Committee makes the following recommendations :

8.07 There is a need to recognize a separate category of Microfinance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could be defined as companies that provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas.

8.08 To ensure that this provision is used by NBFCs which are focused on providing microfinance to the poor, it should be specified that at least 80% of the assets of MF-NBFCs should be in the form of microcredit of upto Rs. 50,000 for agriculture, allied and non farm activities and in case of housing, loans upto Rs. 1,50,000, per individual borrower, whether given through a group mechanism or directly.

MF-NBFCs as BCs

8.09 MF-NBFCs operate in a limited geographic area and have local feel. To enable the poor to have access to savings services, MF-NBFCs may be recognized as Business Correspondents of banks for only providing savings and remittance services.

Relaxation in FIPB guidelines

8.10 Current guidelines used by FIPB (Foreign Investment Promotion Board) require a minimum of US\$ 500,000 equity investment from a foreign entity. NBFCs are eligible to access such funds and leverage local capital market financing. MF-NBFCs may be able to attract social investors with relatively modest means for whom such a high level of investment may be beyond reach. As MF-NBFCs’ initial capital needs may not be very large, the Committee is of the view that the minimum amount of foreign equity for MF-NBFCs may be reduced to a level of US\$ 100,000.

8.11 To facilitate raising Indian equity, NABARD may extend equity support out of its MFDEF to such MF-NBFCs based on objective rating / criteria. NABARD may accord priority in providing equity support to those MF-NBFCs operating in regions featuring high levels of exclusion.

8.12 To further facilitate raising India equity, the SEBI Venture Capital Guidelines may permit Venture Capital Funds to invest in MF-NBFCs.

Tax Concessions

8.13 To facilitate build up of reserves, MF-NBFCs may be allowed, like Housing Finance Companies and Infrastructure Companies, tax concessions to the extent of 40% of their profits, as a proportion to their business portfolio in excluded districts as identified by NABARD without attracting tax. For this, the Committee recommends that MF-NBFCs may be included as eligible institutions under Section 36(1) (viii) of the Income Tax Act.

MF-NBFCs as microinsurance agents

8.14 The lives and livelihoods of poor households are full of uncovered risk. Hence insurance is essential for them. To enable MF-NBFCs to offer risk mitigation services to the poor, the Committee recommends that the IRDA Microinsurance Guidelines, 2005 may permit MF-NBFCs to offer microinsurance services as agents of regulated life and non-life insurance companies.

Code of conduct

8.15 A voluntary mutual code of conduct has been prepared by some MFIs covering aspects including mission, governance, transparency, interest rates, handling of customer grievances, staff conduct, recovery practices, etc. After due consultations within the sector, such code of conduct may be made mandatory for MFIs.

Accounting and Disclosure Norms

8.16 The Institute of Chartered Accountants of India (ICAI) may be involved in formulating appropriate accounting and disclosure norms for MFIs, so that they can generate confidence.

8.17 The cost of funds for MFIs, their operating costs, risk premium, etc., have to be studied for a better understanding of viable and economic rates of interest that can be charged by them. Banks lending to MFIs may undertake such studies and exercise a lender's discipline in enforcing reasonable rates of interest and acceptable modes of recovery.

Unifying regulatory oversight

8.18 At present, all the regulatory aspects of microfinance are not centralized. For example, while the Rural Planning and Credit Department (RPCD) in RBI looks after rural lending, MF-NBFCs are under the control of the Department of Non-Banking Supervision (DNBS) and External Commercial Borrowings are looked after by the Foreign Exchange Department. The Committee feels that RBI may consider bringing all regulatory aspects of microfinance under a single mechanism. Further, supervision of MF-NBFCs could be delegated to NABARD by RBI.

Micro Financial Sector (Development and Regulation) Bill, 2007

8.19 The Micro Financial Sector (Development and Regulation) Bill, 2007 has been introduced in Parliament in March 2007. The Committee feels that the Bill, when enacted, would help in promoting orderly growth of microfinance sector in India. For improving the effectiveness of the Bill, the Committee makes the following suggestions :

- NBFCs and Section 25 companies are left out of the purview of the proposed Bill. NBFCs are currently regulated by RBI, though RBI has exempted them for registration as NBFCs if they do not take deposits. It is recommended that Section 25 companies can be brought under the purview of this Bill.
- Cooperative societies registered under the “MACS Act” – promulgated by some of the States – are eligible to mobilize savings from their members. For mobilizing savings, these societies also need to be registered with NABARD under the proposed Bill. Hence, there is likely to be conflict between “MACS Act” and the proposed Bill. Moreover, cooperative societies provide savings and credit facilities to their own members. It is, therefore, suggested that the cooperatives can be taken out of the purview of the proposed Bill.

Chapter – 9

Technology Applications

Technology – The Driving Force for Low-cost Inclusion Initiatives

9.01 The recent developments in banking technology and expansion of telecommunication network in the hinterlands of the country have provided the perfect launch pad for extending banking outposts to remote locations without having to open bank branches in the area. The Committee feels that this could be achieved by leveraging technology to open up channels beyond branch network and create the required banking footprints to reach the unbanked so as to extend banking services similar to those dispensed from branches. In short, technology has to enable the branch to go where the customer is present, instead of the other way around.

9.02 Further, RBI's Annual Policy for 2007-08 also urged the banks to scale up efforts for IT-based financial inclusion and develop technologies that are highly secure, amenable to audit and follow widely accepted open standards to allow inter operability among the different systems adopted by different banks. The enabling provisions and support of RBI has facilitated successful pilot projects in use of IT for extending the banking outreach for the "excluded". These projects are premised on technology which uses hand-held devices and connectivity with host computers through General Packet Radio Service (GPRS) / Global System for Mobile Communications (GSM) / Code Division Multiple Access (CDMA) / landline networks. The devices also come in several forms like Simputers (Simple In-expensive Multi-lingual Computers) / personal digital assistants, programmed mobiles, etc. There are also rural bio-metric ATMs which have been introduced by banks and found to be very popular among rural masses. Some major banks are introducing low cost rural ATMs for cash dispensing and other services in rural areas.

9.03 The Committee took cognisance of the fact that the RBI has set up an advisory group for IT-enabled financial inclusion to facilitate development of IT solutions for delivery of banking services. It is understood that the group will advise certain minimum parameters and standards that are essential for setting up robust inter-operable systems on open platforms. The Committee, while concurring with this approach, is of the view that nearly all models converge on certain essential components and processes to be followed in a technology application. The essence of all the models under consideration features the issue of a smart card to the farmer on which all his transactions are recorded, a hand-held terminal with the BC at the village level and a Central Processor Unit (CPU) linking the smart cards and BC terminals with the banks. The precautions taken ensure that every transaction made is accompanied by a print-out being provided to the farmer. There are also other models where smart cards are dispensed with and mobile telephones, etc. are used.

9.04 However, for better clarity, the Committee has thought it appropriate to delineate the fundamental outlines of a technology-based model in Annexure VIII which may be examined for application in such manner and to such extent as may be deemed fit.

9.05 The Committee also perused two initiatives – the SBI Tiny Initiative on Banking Facility thru' use of smart card facility and Government of Andhra Pradesh (GoAP) Project on Social Security Payments thru' Smart Cards – to draw conclusions

that can be helpful in devising the strategy for achieving 100% financial inclusion in the country. These are indicated in Annexure IX.

9.06 The operating costs of the various models outlined in Annexure VIII are expected to be minimal and can be easily absorbed by banks as the increase in business volumes will justify the absorption of incremental operating costs. Also, the costs of the models are substantially lowered if the infrastructure is shared. It is, therefore, recommended that a shared infrastructure of different banks enabling nationwide financial inclusion for the participant banks would confer large scale benefits and also enable effortless transfer of funds between the card holders of the various banks.

9.07 Essentially, the start up costs are the initial investment costs comprising cost of the smart card, terminals to the BC and the CPU. The Committee is of the view that the Financial Inclusion Technology Fund can provide the necessary support for defraying technology application and hardware costs of technology adoption.

9.08 As the technological capability for achieving outreach has been satisfactorily proved in the ongoing projects at Andhra Pradesh, Karnataka, Mizoram, etc., banks are urged to scale up the projects all over the country to achieve financial inclusion.

Optimisation of Existing Infrastructure

9.09 The Committee is of the opinion that the existing banking infra-structure and NGOs which have already developed extensive inroads into rural areas should be made optimal use of for enabling outreach of banking services. The BF/BC models backed by technology applications should encourage a role for the small players and integrate them into the national system. The Committee is of the opinion that State Governments should make payments to NREGP and Social Security Payments through such technology-based solutions.

Building database

9.10 The Committee having discussed extensively the issue of using technology as a driver is of the opinion that the requirement of rapid financial inclusion as a national goal can only be achieved by using appropriate IT. The creation of a national database, sectoral, geographic and demographic reports, and also a payment system among the card holders to benefit the under privileged unbanked population of the country is not possible without extensive use of IT. This alone can bring down the costs of the small ticket transactions of the financially included and make nationwide financial inclusion a reality.

9.11 The technology suppliers and banks should evolve common minimum standards for ensuring inter-operability between their systems.

Chapter – 10

Remittance Needs of the Poor

10.01 The credit needs and avenues for safe custody of savings for the poor have been recognized as areas of substantial gaps and have been sought to be addressed by expansion of bank branches, cooperative credit structure and microfinance initiatives. However, the remittance needs have traditionally been thought to be well met by money orders from Post Office, sale of traveler's cheques, demand drafts by banks and through informal sources, including physical carrying of cash by the poor themselves and their relatives and friends.

Remittance System Required by the Poor

10.02 The poor need a remittance system to send money to their families when they migrate out of their villages or towns. Situations often arise when migrant workers in a city remit money to their families in the village or when parents in the village need to remit money to their children in the city. Other cases of remittance could arise on account of transfer payments by Government or remittances of miscellaneous nature. As such the service they need should meet the following criteria :

- a. Accessible service - The product should be available to them without unnecessary hassle. Entry barriers such as existing relationship with banks, possession of checkable accounts or filling up long forms act as deterrents in accessing the services.
- b. Timeliness and certainty of delivery - Predictability of delivery at the recipient's place is important for those who depend on remittances for meeting their basic needs.
- c. Cost effectiveness, affordability and value for money services - The remittance needs are mostly repetitive and small value. The present system of remitting through post offices is costly. Other sources are risk prone, further adding to the cost of the service.
- d. Receipt of delivery status - Timely confirmation of delivery is a requirement for poor people who have limited access to communication facility.

10.03 With new technology and computerization of banking operations, new remittance products have been introduced in the market, which have increased the speed, cost effectiveness and efficiency of the payments and settlement system. These include the National Electronic Funds Transfer (NEFT), Electronic Clearing System (ECS), Real Time Gross Settlement (RTGS) and ongoing endeavour at cheque truncation system leading to a national payment and settlement system.

10.04 While these systems meet the needs of a modern economy, they leave the financially excluded sections of the population untouched. The basic requirement of ECS and cheque transactions is a checkable account with a bank which offers these products. The RTGS is also a bulk payment facility and would be addressing the needs of high value settlements. As such these systems pose a high entry barrier for the financially excluded sections. This calls for a conscious attempt to build a payment and settlement system that caters to the needs of the poor and excluded sections of society.

10.05 One of the starting points in this direction is the present drive at financial inclusion through “no frills” accounts and use of BFs and BCs. However, it would be useful to look also into a few international experiences in expanding the choice of remittance facilities for the poor.

International Experiences

10.06 Wizzit, a South African company enables customers to use their phones to send funds to one another, buy airtime and pay their bills. The funds come from customer accounts at Wizzit, which operates as a bank in South Africa under license from the Johannesburg-based South African Bank of Athens (SABA). SABA is a subsidiary of the Athens-based National Bank of Greece⁶.

10.07 Globe Telecom, a mobile service provider in Philippines provides an e-wallet facility to its customers. The product turns cell phone into an e-wallet, and the customers can use their phones to transact business. Non subscribers can send money electronically to Globe mobile subscribers⁷.

Experiences from India

10.08 In India, mobile services are presently used for conveying information regarding banking transactions. The potential exists to expand the services for enabling remittance facilities through mobile phones. Already no frills accounts and Government payments are being routed through mobile network and telephone on a pilot basis at Warangal, Pithoragarh and Aizwal.

10.09 One successful example of suitable remittance product is the model adopted by Ahmednagar DCCB. It has implemented a system of low cost anywhere banking solution which has a facility of card to card transfer. Savings / current account holders at all its 280 branches have a choice to keep their savings bank account or a part thereof in a separate account at the bank's head office. Customers can have access to this account from all the bank branches. Each branch has been provided with two PoS devices which are connected through a dial-up telephone line to the head office. The customers can go to any branch and deposit or withdraw cash after authenticating access to their account. About 30,000 cards have already been issued. Wholesale dealers have adopted the model and ask retailers to make payments through this mechanism. Add-on cards have also been provided to the customers asking for the same. An account holder at a village can deposit cash in the village branch of the bank and her children studying in the city can withdraw cash from another card. It was learnt that the customer is charged only Rs.4 per transaction. Such experiments may be studied for replication.

10.10 A low-value card, linked to a bank account, which can be encashed at PoS and which would allow transfer of small amounts from one card to another, would alleviate the problems that poor face in getting affordable remittances facilities. This would require national switch with linkages to PoS. Further, this would substantially increase banking outreach as at present there are about 3 lakh PoS as compared to around 70,000 scheduled commercial bank branches and 22,000 ATMs. However, a majority of PoS machines are now located in urban and semi-urban areas. It is expected that as the system takes roots more PoS will come in rural areas, facilitating such transfers.

⁶ <http://www.bai.org>

⁷ <http://www1.globe.com.ph>

10.11 The e-kiosks in villages could be yet another source of operating a remittance system that is accessible to the poor.

10.12 Thus, while the financial inclusion through opening of no frills accounts with banks would improve the remittance facility for the poor, a conscious effort at devising a product within the existing payment and settlement system would enable the poor to benefit from the improvements in banking technology.

10.13 From the above it is quite clear that when it comes to transferring money from one village to another, the poor in India are substantially challenged. Both the originator and the beneficiary have to sometimes travel quite a lot of distance to be in a position to send/ receive money. Also, the base fees for enabling a transfer work adversely against small ticket remittances. For small transfers, the fee itself would constitute more than 25% of the remittance. The remittance needs of the poor may have to be met by a multi-pronged strategy which uses the existing infrastructure optimally and in addition, new products should be introduced which leverage on technology.

Other Recommendations

10.14 The following additional suggestions would substantially alleviate the remittance needs of the poor in the country :

- The combined network of nearly 70000 branches of scheduled commercial banks (including RRBs) and a network of more than 1.50 lakh post offices can ideally provide the institutional mechanism for extending remittance facilities in remote areas. With adoption of appropriate technology, it may be possible to bring down the transaction costs which would encourage and enable the poor to make use of such remittance facilities. A committee may be set up with representatives from RBI, Department of Posts, NABARD and commercial banks for exploring the feasibility of integrating postal network with the banking system and developing a nation wide remittance system.
- The remittance product could be an electronic product similar to “Instacash” where a 16 digit code is given to the originator of the transaction, and the beneficiary can take the amount from select post offices by giving the code, and identity proof. This product should be available across banks, post offices and other institutions and be affordable. Another option could be to credit the remitted amount to a central server at the originating point and at every touch point should be able to withdraw it.
- Banks should endeavour to have a BC touch point in each of the six lakh villages in the country. There should be a micro-bank in every village.
- Banks should introduce card-based remittance products which can be encashed all over the country. This may be card to card transfer, or simply a scratch card type remittance card.

Chapter – 11

Micro Insurance

Need for Micro-Insurance – Risks Faced by the Poor

11.01 Micro-insurance is a key element in the financial services package for people at the bottom of the pyramid. The poor face more risks than the well-off, but more importantly they are more vulnerable to the same risk. Usually, the poor face two types of risks – idiosyncratic (specific to the household) and covariate (common, eg., drought, epidemic, etc.). To combat these risks, the poor do pro-active risk management – grain storage, savings, asset accumulation (specially bullocks), loans from friends and relatives, etc. However, the prevalent forms of risk management (in kind savings, self-insurance, mutual insurance) which were appropriate earlier are no longer adequate.

11.02 Poverty is not just a state of deprivation but has latent vulnerability. Micro-insurance should, therefore, provide greater economic and psychological security to the poor as it reduces exposure to multiple risks and cushions the impact of a disaster. There is an overwhelming demand for social protection among the poor. Micro-insurance in conjunction with micro savings and micro credit could, therefore, go a long way in keeping this segment away from the poverty trap and would truly be an integral component of financial inclusion.

Defining Micro-Insurance

11.03 The draft paper prepared by the Consultative Group to Assist the Poor (CGAP) working group on micro-insurance defines micro-insurance as “the protection of low income households against specific perils in exchange for premium payments proportionate to the likelihood and cost of the risk involved.” The paper deliberates on the key roles to be played by all stakeholders – insurers, regulator and the Government. The working group also agrees that the cost of such cover should be affordable.

Consultative Group on Micro-Insurance Constituted by GoI

11.04 In 2003, GoI constituted a Consultative Group on Micro-Insurance to examine existing insurance schemes for rural and urban poor with specific reference to outreach, pricing, products, servicing and promotion and to examine existing regulations with a view to promoting micro-insurance organisations with specific reference to capital requirements, licensing, monitoring and review, etc. The report of the consultative group has brought out the following key issues :

- Micro-insurance is not viable as a standalone insurance product.
- Micro-insurance has not penetrated rural markets. Traditional insurers have not made much headway in bringing micro-insurance products to the rural poor. (In addition, the Committee feels that micro insurance has not penetrated even among the urban poor).
- Partnership between an insurer and a social organisation like NGO would be desirable to promote micro-insurance by drawing on their mutual strengths.
- Design of micro-insurance products must have the features of simplicity, availability, affordability, accessibility and flexibility.

Findings of the UNDP Study Report

11.05 A study commissioned by the United Nations Development Programme (UNDP) titled “Building Security for the Poor - Potential and Prospects for Micro-insurance in India” states that 90% of the Indian population - some 950 million people - are not covered by insurance and signify an untapped market of nearly US\$2 billion. This enormous “missing market” is ready for customized life and non-life insurance, but first, serious mismatches between the needs of the insured and the insurers must be overcome, pitting priorities against profits.

11.06 The UNDP report has analysed six key issues pertinent to the growth of the micro-insurance industry in India, capturing the concerns of different stakeholders as indicated below :

- (i) There are specific reasons for low demand for insurance in spite of intense need. Suppliers have their own concerns which helps to explain why there have been so little efforts at market development. Consequently, the rural market is characterized by limited and inappropriate services, inadequate information and capacity gaps.
- (ii) There are challenges in product design, which has resulted in a mismatch between needs and standard products on offer. Efforts at product development / diversification have been limited.
- (iii) Pricing, including willingness to pay and the availability of subsidies, influence the market. In the absence of a historical data base on claims, premium calculations are based on remote macro aggregates and overcautious margins. Building and sharing claims histories can help in aligning pricing decisions with actuarial calculations, thereby reducing prices.
- (iv) Difficulty in distribution is one of the most cited reasons for absence of rural insurance. The high costs of penetrating rural markets, combined with underutilization of available distribution channels, hinder the growth of rural insurance services. This adds to costs, both, managerial and financial. Like inclusive credit, inclusive insurance is expected to be a “low ticket” business, requiring volumes for viability.
- (v) Cumbersome and inappropriate procedures inhibit the development of this sector.
- (vi) Contrasting perspectives of the insured and the insurers, lead to low customization of products and low demand for what is available.

11.07 The UNDP report further states that micro-insurance solutions should, therefore, attempt at addressing key issues that will improve customer satisfaction (demand-supply gaps, appropriate products and pricing), provide distribution efficiencies for better outreach and remove procedural hassles facilitating easier renewals and claim settlements. With a view to reduce costs, the report has also suggested that the premia payable on micro-insurance be exempted from payment of service tax, which will also enable greater penetration in rural markets.

Enabling Environment for Micro-Insurance in the Indian Context

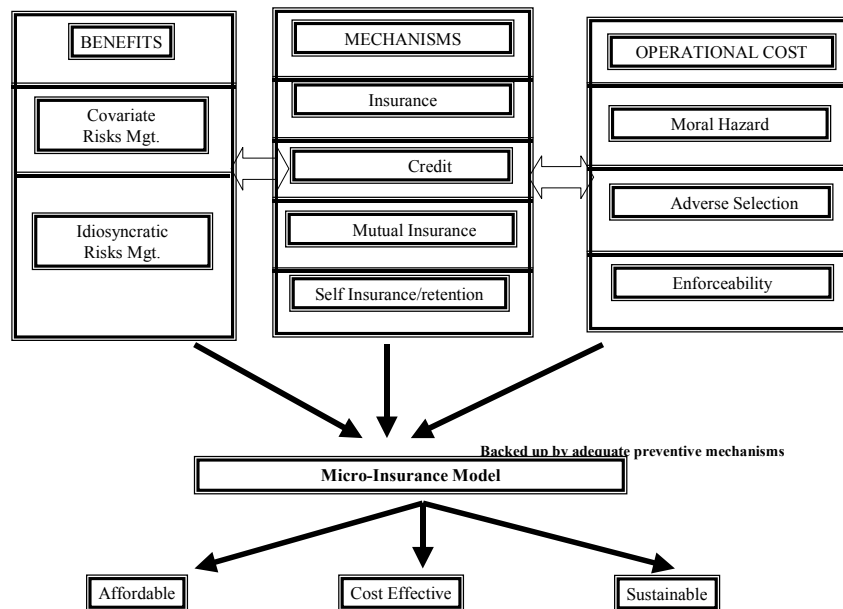
11.08 Helping the rural poor systematically manage financial risks to their livelihoods and lives through micro-insurance offers innovative ways to combat poverty in India. The timing of the UNDP study is strategic as policy interest has been renewed in energizing the rural insurance market in India. The following factors could

provide the needed impetus to push micro-insurance to the “next level” in terms of growth and outreach :

- The widening, deepening and upscaling of microfinance interventions has provided the institutional precincts on which the edifice of micro-insurance could be built in rural areas.
- There are a wide range of developmental programmes being supported by the Government like the SGSY, the NREGP, etc., which have facilitated the improvement of income levels of many rural households. The GoI-package of “Doubling Flow of Agricultural Credit” has also enabled greater institutional credit flow for agriculture and allied activities. However, what is of concern is that all these interventions, though ambitious in stated intent, only incidentally address risk, if at all. The most vulnerable rural population - in particular, women - are largely excluded from the insurance market. This only amplifies the felt need of this segment for protection of their lives / income-generating assets against various perils. At present, the Personal Accident Insurance Scheme (PAIS) which is being provided as a bundled offering along with the *Kisan Credit Card (KCC) Scheme* and the *Rashtriya Krishi Bima Yojana (RKBY)* for insuring crops, are, probably, the only borrowal-linked risk-mitigation mechanisms available to rural households. Further, many State Governments are offering health insurance facilities to the rural poor (eg., *Yeshaswini* Scheme of the Government of Karnataka) which have also generated considerable acceptance and awareness about insurance products in the rural areas.
- In October 2004, the RBI permitted RRBs to undertake insurance business as a “corporate agent” without risk participation. As RRBs have a network of branches in rural areas, they could play an important role in increasing outreach.
- Though the 2005 IRDA regulations on micro-insurance have some restrictive aspects, they have also a number of positive features. Its most innovative feature is legally recognizing NGOs, MFIs and SHGs as “micro-insurance agents.” This has the potential of significantly increasing rural insurance penetration.
- Many commercial banks have partnered foreign insurance companies for providing life insurance policies. Thus, banking outlets (which number close to 70,000) and more than 1 lakh cooperative societies could provide the needed outreach to purvey micro-insurance facilities, without any further addition to transaction costs.

Addressing Differing Perspectives in Micro-Insurance

11.09 As already indicated, there are contrasting perspectives which have traditionally impeded the growth of this sector globally. The same is true of the Indian experience also. The competing perspectives of the insured, viz., need, affordability and willingness vis-à-vis the insurer’s, viz., insurability, profitability and deliverability continue to be the core dilemma in micro-insurance thru’ institutional sources. Further, the core problems in institutional insurance, viz., moral hazard, adverse selection and poor infrastructure which results in high claims costs, administrative costs and consequently inadequate coverage have to be addressed effectively, for enabling the growth of an affordable, cost-effective and sustainable model.



Delivery Mechanism : Micro-Insurance Models

11.10 A key concern in the pricing of an insurance product is the element of cost of acquisition and its delivery. Obviously, the delivery costs have to be contained to keep the cost of insurance sufficiently low to attract the poor and to incentivise the insurer to venture into this segment viewing it as a genuine market opportunity.

11.11 The Committee studied four different models for delivering micro-insurance services to the targeted clientele :

Partner - Agent Model :

- Insurers utilize MFIs' delivery mechanism to provide sales and basic services to clients.
- There is no risk and limited administrative burden for MFIs.

Full Service Model :

- The provider is responsible for all aspects of product design, sales, servicing, and claims assessment.
- The insurers are responsible for all insurance-related costs and losses and they retain all profits.

Community Based Model :

- The policy holders own and manage the insurance program, and negotiate with external health care providers.

Provider Model :

- The service provider and the insurer are the same, i.e., hospitals or doctors offer policies to individuals or groups.

Recommendations

Leveraging Existing Network for Micro-Insurance

11.12 It would be difficult for the insurers to establish a vast network for distribution of micro-insurance products. They need to utilize existing Government organizations, banks, MFIs, NGOs and SHGs to increase the outreach of micro-insurance to the poor. The advantages of these entities are that they find greater acceptability among the financially excluded, and with a better understanding of their needs are well equipped to advise them on the choice of products. In India with a vast rural population characterized by challenges and complexities, it makes sense to latch on to an existing mechanism operating in these segments to lower costs and to help the insurer to leverage on the faith already generated by the entity. Hence it would be prudent to choose a partner-agent model for delivery where the insurer underwrites the risk and the distribution is handled by an existing intermediary. This model keeps the cost of insurance attractive enough for the poor to enter and remain in its fold even while addressing the concern of the insurers about the low returns of micro-insurance.

Linking Micro-credit with Micro-insurance

11.13 It is becoming increasingly clear that micro-insurance needs a further push and guidance from the Regulator as well as the Government. The Committee concurs with the view that offering microcredit without micro-insurance is bad financial behaviour, as it is the poor who suffer on account of such bad product design. There is, therefore, a need to emphasise linking of microcredit with micro-insurance.

11.14 Linking micro-insurance with micro-finance makes good business sense. Further, as it helps in bringing down the inherent risk cost of lending, the Committee feels that NABARD should be regularly involved in issues relating to rural and micro insurance to leverage on its experience of being a catalyst in the field of micro-credit.

Implementation Strategy for Micro-Insurance

11.15 Keeping in view the various issues dealt with earlier in this Chapter, the Committee has identified five major areas for formulation of strategies for effective implementation of micro-insurance programmes. These are explained in the following paragraphs :

Human Resources Requirement and Training

11.16 As indicated earlier, the UNDP report states that there is a huge untapped market – of around 950 million people and nearly US\$2 billion – for insurance in India. IRDA may consider putting in place an appropriate institutional structure for deciding on service packages including premia and formulating strategies for effective promotion of micro insurance. There is also a felt need for development, of both full-time and part-time staff, thru' effective training in insurance marketing and servicing concepts.

Operations and Systems

11.17 To address the requirements of the huge market potential available, appropriate systems should be evolved for tracking client information, either manually or using technology. While a technology platform may take time for setting up, in the long-run, the same will be cost-effective and reliable. Similarly, the procedures for premium payments, claims and other services should be formalized along with increased customization of products to stimulate demand.

Development of Adequate Feedback Mechanism

11.18 Keeping in view the diverse nature of market requirements, suitable mechanisms to collect market intelligence, collating and interpretation of the same, in a formally structured manner, is important for product development and process refinement. Insurance companies should go beyond devising new products to improving their processes for building awareness, marketing enrollment, premium collection, claim settlement and renewal. For this they need use innovative channels such as business correspondents, SHGs, NGOs and MFIs as also cooperatives and mutual associations. Further, the use of technology such as mobile phones and ATMs for premium collection should be encouraged to keep transaction costs low.

Development of Data Base

11.19 High costs of penetration and acquisition often leads to higher pricing of products, thereby impacting client outreach and market depth. Building up historical data base on risk profiles, claims, settlement ratios, etc., will facilitate in better pricing of products, based on actual rather than presumed risks. Besides enabling cost reduction, warehousing of such data will make the market more transparent for entry of more operators. The IRDA and the Government should help in provision of data such as human mortality and morbidity, weather parameters and livestock mortality/morbidity, on a timely, large sample and regular basis. This will lead to finer pricing on actuarial basis and eventually cut costs of insurance.

Consumer Education, Marketing and Grievance Handling

11.20 The micro-insurance sector is unique in the sense that there is an ongoing challenge to explain the concept and benefits to the insured. Creating awareness thru' use of pictorial posters, local folk arts and street theatres might be useful to explain the mechanisms of insurance. Local community-based organisations could organize premium collections, as they have better access to the local people. To make it more acceptable to the people, micro-insurance products, apart from covering only risks, should also provide an opportunity for providing long term savings (endowment).

IRDA's Regulations on Micro-Insurance

11.21 Building on the recommendations of the consultative group, IRDA notified Micro-Insurance Regulations on 10th November 2005 with the following key features to promote and regulate micro-insurance products. The regulations focus on the direction, design and delivery of the products :

- A tie-up between life and non life insurance players for integration of product to address risks to the individual, his family, his assets and habitat,
- Monitoring product design through "file and use",
- Breakthrough in distribution channels with inclusion of NGOs, SHGs, MFIs and PACS to provide micro-insurance, with appropriate compensation for their services,
- Enlarged servicing activities entrusted to micro-insurance agents,
- Issue of policy documents in simple vernacular language.

11.22 Currently the IRDA regulations do not favor composite insurance (i.e., life and non-life insurances by the same company) and also limit the agency tie-up to one life and one non-life insurer. However, in recognition of the uniqueness of micro-

insurance, these regulations enable life and non-life companies to tie-up for offering a combined policy in rural areas. Further, the IRDA has allowed insurers to issue policies with a maximum cover of Rs. 50,000 for general and life insurance under these regulations. The regulations have also eased the norms for entry of agents relating to training and pre-recruitment examination. As an attraction, remuneration to agents has also been leveled across the term of the policy.

11.23 Another striking feature of the regulation is the provision of extending coverage to the family as a unit as against the system of insurance coverage to individual lives. The insurer has to take IRDA's prior approval for launching micro-insurance products through the "file and use" mode. The maximum cover will be Rs. 30,000 per annum for a dwelling and contents or livestock or tools or implements or other named assets or crop insurance against all perils. For individual and group health insurance, the maximum cover is Rs. 30,000 per annum per individual. For personal accident policies the maximum Rs. 50,000 per annum and is open to 5-70 age group.

11.24 In case of life micro-insurance products, the cover amount for term insurance ranges between Rs. 5,000-50,000 for a minimum term of five years and maximum of 15 years. The entry age for this product is kept between 18-60. Endowment insurance policy provides cover for Rs. 5,000-30,000 for a minimum five years and maximum 15 years for people aged between 18 and 60. Further, an insurer can collect the premium for both life and general insurance components directly from the consumer or agents.

11.25 At the time of opening of the insurance sector, IRDA had decided that all insurers, including the new entrants, should fulfill certain obligations to spread insurance in rural areas. Specific regulations have been issued prescribing targets in terms of quantum of policies to be written in the rural sector consistent with the years of their operations and also certain quantified target for coverage of lives in the social sector. With a view to encouraging the insurers to meet these obligations and give a fillip to micro-insurance products, IRDA also decided that all micro-insurance products may be reckoned for the purpose of fulfillment of the social obligation and where such policy are issued in rural area they could also be reckoned for rural sector obligation. IRDA has also proposed to benchmark the above obligations with reference to quantified limits of sums assured under micro-insurance policies. The above approach would ensure the faster development of the micro-insurance market and take the insurance penetration to rural areas.

11.26 The Committee wholly subscribes to the initiatives of IRDA in widening outreach of micro-insurance products to the rural poor and recommends that the same may be implemented with renewed zeal as providing micro-insurance is a necessary and essential adjunct in the inclusive process. The IRDA should continue to impose Rural and Social Sector Obligations but there should be no unreasonable caps on premiums and channel commissions. This is in line with the de-tariffing process in other sectors also. In the long run, it is only when the insurance companies find it profitable to serve this market that they will do so on their own.

Other Recommendations

11.27 Micro-insurance in India is a new concept and in the real sense, is yet to be tested for its conduciveness to the needs of the target segment. The most significant constraint is the lack of base line data on potential claims that can help the insurers to

design or price products. The consumption and saving patterns are also a critical aid to assess the insurance needs. The issue of moral hazard and adverse selection is a matter of concern for the insurer. Above all, spreading awareness among this segment of insurable population and capacity building of the delivery organisations are major challenges.

Product Development / Process Re-engineering

11.28 Customised product development to suit the varying requirements of the local populace is a pre-requisite. The processes / procedures are to be streamlined and simplified, to facilitate easier access for the rural poor. Information should be made available in vernacular for easy understanding of the terms on offer.

Building Data Base

11.29 With a view to bringing down product costs, building data base of claim histories, risk profiles, etc., are to be undertaken. This will also help in aligning pricing decisions with actuarial calculations.

Using Existing Infrastructure

11.30 Micro-insurance service providers can use the existing banking infrastructure and also adopt the agency-mode (NGOs, SHGs, NBFCs, etc.) for providing services, thereby leveraging on the existing physical branch network and reducing costs.

Use of Technology

11.31 The technology platforms being envisioned to facilitate financial inclusion should enable micro-insurance transactions also. Towards this end, there is a need to integrate the various modules - savings, credit, insurance, etc. - into the technology framework so that holistic inclusive efforts are possible in the rural areas.

Review of existing schemes

11.32 There are a large number of group life and health insurance schemes which are run by various central ministries and State Governments. The level of actual coverage in terms of claims preferred and settled in such schemes is disturbingly low. These schemes should be reviewed by an expert group set up by the IRDA.

11.33 The above are general recommendations. However, with reference to specific segments, the Committee makes the following recommendations:

(a) Life Insurance:

11.34 A wide range of products are available but penetration is really limited in rural areas. The procedural requirements at the time of entry and in case of claims settlement are cumbersome. The commission structure for agents is also heavily weighed in favour of getting new policies with very little incentive to service existing policies. In this regard, Micro Insurance Guidelines (MIG) 2005 issued by IRDA has provided for equal commission throughout the life of a policy and this will now remove the disincentive in servicing existing policy holders.

(b) Health Insurance:

11.35 In case of Health Insurance, penetration level is even much lower than Life Insurance. The two categories viz., Critical Illness and Hospitalisation are the main product segments. Some State Governments have developed Health Insurance schemes which are still in very early stages. The Committee has observed that

mutual health insurance models have advantages of its members performing a number of roles such as awareness creation, marketing, enrolment, premium collection, claims processing, monitoring, etc. Under this arrangement, the costs of offering small-ticket health insurance gets significantly reduced. The high covariant risks such as epidemics will have to be taken care of by a mutual entity taking reinsurance for such risks. IRDA has also suggested that the capital requirements for stand-alone health insurance companies be reduced to Rs.50 crore as against Rs.100 crore for Life Insurance Companies and the Committee endorses the same.

(c) Crop Insurance:

11.36 This is a very important risk mitigation arrangement for small and marginal farmers. However, the present scheme suffers from very serious implementation problems. Leaving the discretion to notify crops/regions to state governments has contributed to adverse selection. Further, claims settlement based on yield estimation has been cumbersome and the sampling area for crop cutting experiments is very large. An alternative model based on weather insurance has been attempted. Farmers are happier with it because of quick settlements. On the down side premium rates are very high. Further, due to low density of weather stations, the problem of large area averaging is a critical factor even with weather insurance. To counter this, there is a need for having a large number of smaller weather stations. The Committee recommends that policies be evolved to make crop insurance universal, viz., applicable to all crops/regions and pricing actuarial.

(d) Livestock Insurance:

11.37 As in Life Insurance, the problem lies in the process of enrollment and claims settlement. Several pilots indicate that the involvement of local organisations like SHGs, dairy co-operatives, NGOs and MFIs improves the quality of service, reduces false claims and expedites claims settlement. The Committee recommends that these experiences be studied and adopted by insurance companies.

(e) Asset Insurance:

11.38 This could cover a wide range including residential buildings, farm and non-farm equipments and vehicles. For poor households, insurance for a hut, irrigation pump, a handloom or a bullock cart could have considerable economic significance. Products are available but penetration levels are negligible. The main constraint seems to be lack of distribution channels appropriate for lower income groups. The Committee again recommends that involving local NGOs, MFIs, SHGs, etc. as distribution channels as well as facilitators of claim settlements would be quite useful.

Inventory of Micro-insurance Schemes - ILO

The ILO (2004) has recently prepared an inventory of micro-insurance schemes operational in India.

The inventory lists 51 schemes that are operational in India.

Most of the schemes were launched in the last 4-5 years.

43 schemes for which the information is available cover 5.2 million people.

Most insurance schemes (66%) are linked with micro finance services provided by specialised institutions or non-specialised organisations. 22% of the schemes are implemented by community-based organisations and 12% by health care providers.

Life and health are the two most popular risks for which insurance is demanded; 59% of schemes provide life insurance and 57% of them provide health insurance.

Most schemes (74%) operate in 4 southern States of India: Andhra Pradesh (27%), Tamil Nadu (23%), Karnataka (17%) and Kerala (8%). The two western States: Maharashtra (12%) and Gujarat (6%) account for 18% of the schemes.

Chapter – 12

Demand side causes and solutions for Financial Inclusion

12.01 The Committee's report has so far concentrated on supply side issues of financial inclusion and what can be done to enhance supply of financial services, through increased outreach by existing institutions, enhancing their incentives to serve the excluded and adding new distribution channels. The Committee is of the view, however, that financial exclusion is also caused by demand side issues – the fact that nearly 22% of the population is below the poverty line, and could not fully participate in the mainstream economy. Unless some steps are taken on the demand side, or in the “real sectors”, mere supply side solutions from the financial sector will not work.

Resource Endowment Issues

12.02 It is widely recognized in economic literature that there are at least five different types of capital – physical (roads, buildings, plant and machinery, infrastructure), natural (land, water, forests, livestock, weather), human (nutrition, health, education, skills, competencies), social (kinship groups, associations, trust, norms, institutions) and financial. One of the causes as well as consequences of poverty and backwardness is inadequate access to all these forms of capital. Thus to look at financial inclusion in an isolated way is problematic.

12.03 Merely pumping a backward region with financial capital is not going to be enough in the absence of improvements on the side of human, social and physical capital. The people in the first place have to be healthy and educated to be productive, so that they can use finance effectively. There has to be a substantial degree of trust and functioning institutions, in other words social capital, for economic transactions to take place in an atmosphere of confidence. Finally, there has to be adequate access to physical capital in terms of roads, bridges, canals, warehouses and market yards, in addition to electric power and telecommunication, for financial capital to be useful. In the absence of all this, merely insisting on financial inclusion will not work. This explains why the credit deposit ratio in some of the eastern States, remains low over several decades. Let us examine the adequacy of various other forms of capital.

Inadequate Human Capital

12.04 Health and education are both essential pre-requisites for financial inclusion. Moreover, access to these services is enabled by access to financial services. Important health indices like life expectancy at birth, infant and under-five mortality levels show that a lot remains to be done.

12.05 On the education front also, quality of education imparted in the mainstream system of education, poor attainment level of children and high drop out rates at all levels need to be tackled urgently. The educationally excluded groups mainly belong to socially disadvantaged groups like the STs, SCs, OBCs and girls from poor households. In such a situation, financial inclusion has to be preceded by effective investments by the government to ensure near universal access to primary health and education.

Inadequate Access to Natural Capital

12.06 Land is the most important form of natural capital, followed by water. In most of the districts and states where financial inclusion is low, a vast majority of the

rural population is either landless or have less than 1 hectare of land. In rainfed areas land ownership is higher, but the percentage that is irrigated is small. For example in Jharkhand, less than 10% of the cultivable land is irrigated. In Vidarbha, the extent of irrigation is only 7% of the gross cropped area. For small farmers the access to land and water resources is a key precondition for using credit. It is in this context that programmes for enhancing access to land and water become relevant. For tribal communities, access to natural capital in terms of forest lands is severely restricted and this adversely affects their livelihoods and the ability to use credit.

Inadequate Physical Capital

12.07 A vast majority of financially excluded regions and districts also suffer from low level of investment in roads, bridges, canals, power supply, market yards and warehousing. The absence of this leads to a general malaise in the local economy and a disincentive for private investments in directly productive sectors.

Underdeveloped Social Capital

12.08 There is a general correlation between financial exclusion and underdeveloped institutions. Gram Panchayats, commodity cooperatives, local administration and even local markets in the financially excluded regions are not well developed. Making these work is again both a pre-condition for financial inclusion, and will be assisted by it.

Productivity Issues

Low Productivity

12.09 The Committee noted that most of the regions which have a low degree of financial exclusion, also exhibit a low level of agricultural productivity. While the Committee was not able to commission any detailed studies on this topic, a cursory review of data indicates a high degree of correlation between low financial inclusion and low agricultural productivity. The Committee is aware of the aphorism that “correlation is not causation”. That is why instead of saying that pumping more credit will enhance agricultural productivity in such regions, it is felt that there is a need for “real sector” interventions to enhance agricultural productivity which would then generate demand for additional finance.

No local value addition

12.10 One of the primary uses of finance is when value is added locally to primary produce. Regions such as Western Maharashtra and Western Uttar Pradesh have become prosperous by not only growing sugar cane but by adding value to it by local processing and marketing. This may be at the traditional level of “gur” or intermediate level of khandsari units, or modern sugar mills. The value chain can be further enhanced by producing by-products from molasses, such as alcohol and co-generated power.

Poor Market Linkages

12.11 The Committee was informed of the weak market linkages that exist both on the input and the output side, in most of the areas characterized by low financial inclusion. The North-Eastern States are a prime example of this - pineapples in Mizoram, ginger in Sikkim and orchids in Arunachal Pradesh - considerable quantity goes waste because they cannot be marketed. The same is true when crops like tomatoes or potatoes are grown and there is a glut. Farmers are unable to sell them to

distant markets due to lack of information / communication and transport linkages. Effective increase in demand for credit in such areas without prior improvement in physical infrastructure will be difficult.

Risk Issues

12.12 Even where rural producers have access to land and water they may suffer from a high variance in yield and productivity levels caused by factors such as rainfall, seed quality, pest attacks and agronomic practices. This leads to higher financial risk. As several studies on the spate of recent farmer suicides show, the primary problem seems to be high risk in agriculture, due to yield as well as price variations. That is why even medium-sized farmers have been committing suicides.

Unorganised Nature of the Excluded

12.13 Apart from suffering from poor resource endowments in terms of low levels of natural, physical, human and social capital the financially excluded segments and regions are characterised by a very low level of social organisation. Due to prevailing levels of distress and uncertainty, people are often reluctant to collaborate or contribute to any common cause. This leads to a situation where collective action institutions such as cooperatives and SHGs thrive in the western and southern regions but not elsewhere.

12.14 People not only do not come together for savings and credit, they also do not come together for input purchase or output marketing or sharing a common production facility or managing a collective resource such as an irrigation canal. In such an atmosphere, mere availability of additional credit to individual producers is not very helpful. Once again, financial inclusion needs to be preceded by social inclusion.

Recommendations

Human Development

12.15 The Committee is of the view that regions, segments and sectors which are financially excluded require substantial investments in human development. In particular, primary health, nutrition, primary education and vocational training need attention. The Twelfth Finance Commission had already taken a lead in this direction by earmarking additional funds for health and education in backward States. The Committee endorses this and is of the view that this will lead to enhanced economic efficiency and consequent demand for financial inclusion, within a few years.

Access to Land and Titling

12.16 The Committee is supportive of various Government programmes under which surplus land is distributed to landless and marginal farmers. The Committee has also noted that the Government has enacted recently The Forest Dwellers and Tribal Land Rights Act, 2006, which will ensure that those who had been cultivating a piece of land for decades in the middle of forests, will now get security of tenure. This will open up the possibility of their accessing credit from banks.

12.17 The Committee has noted and endorses the recent move by NABARD to provide refinance for credit extended by banks and co-operatives to oral lessees and tenant farmers. This category of farmers has long been financially excluded due to lack of land titling or recorded tenures. Procedural changes in banks must be brought about to extend credit outreach to all such productive farmers.

12.18 Banks hesitate to finance tenant farmers / oral lessees as they do not have documentary proof of their right to till the land for raising crops or for investment purposes. Recording of tenancy and ownership rights on land is an important measure to enable access to credit.

12.19 Certificates by revenue officers or a system of land cultivation certificate by the Village Panchayats or local bodies may be made acceptable as documentary proof for cultivating the land.

12.20 Computerisation of land records will lead to systematization of land records and overall availability of required information to banks facilitating their loan appraisal process. It will also facilitate online search and eventual registration of charges on land. It is observed that 12 States have already initiated the process and GoI may advise all States to give priority for completing this process within a year. This will reduce cost to farmers in obtaining various documents and recording encumbrance.

Access to Work – NREGA

12.21 Given the fact that nearly 80% of farmer households in the country are small and marginal farmers, who rarely have work on their own farms for more than 100 days a year, the availability of wage employment in the vicinity of their villages is critical. In this context the Committee noted the nation-wide roll-out plans supported by the National Rural Employment Guarantee Programme (NREGP) which ensures that every household in need can ask for paid wage work for upto 100 days per year.

12.22 The Committee was given to understand that in certain States, such as Andhra Pradesh, all payments under the NREGP will be made to the beneficiaries through their bank accounts, most of which will be specially opened for this purpose. In Andhra Pradesh, the beneficiaries / depositors will be issued smart cards to enable transactions at several locations besides the bank branch. The Committee endorses this type of creative use of the NREGP payments to enhance financial inclusion.

Infrastructure Support

12.23 The Committee noted significant progress made for rural connectivity through the Pradhan Mantri Gram Sadak Yojana and the attempt to extend electric power to unconnected villages through the Rajiv Gandhi Gram Vidyutikaran Yojana. In several states the RIDF managed by NABARD has enabled the creation of much needed roads, bridges, irrigation canals, water harvesting structures and other useful infrastructure. The Committee endorses this and recommends a further impetus in the area.

12.24 The National Development Council (NDC) has recommended that the normative allocation of RIDF funds among States should be decided by factoring in, *inter alia*, the CD Ratio as a relevant criterion. This should be attempted by NABARD to improve equitable distribution of RIDF resources.

Enhancing Productivity and Incomes

Productivity Enhancement

12.25 The Committee is of the view that banks cannot be mute spectators in regions where agricultural productivity is low. In their own interest, to generate future credit business and attendant deposits, banks need to support the enhancement of agricultural productivity. The whole concept of SBI running agricultural development

branches in 1970s was based on this premise. The Committee notes that in the last decade the efforts by banks to provide extension services have reduced. This is not in the long run interest of the banks themselves.

12.26 In this connection, the Committee has already recommended the establishment of Nodal Branches in each block to undertake intensive efforts for agricultural and business development services to farm and non-farm sector borrowers respectively. The Committee also recommends that banks explore tie-ups with government extension agencies, Krishi Vigyan Kendras, reputed NGOs working in this field, agri-business clinics and corporates engaged in agricultural activities, to provide inputs, extension services and market linkages to the bank's borrowers so as to offer credit plus services and enhance the efficacy of credit.

Local Value Addition

12.27 The Committee recommends that efforts should be made to ensure that all agricultural produce is subjected to primary and if possible secondary value addition locally. This means that post-harvest drying, sorting, grading and packing, can be done at the village level, preferably by women SHGs. Farmers groups can come together to establish secondary value addition facilities such as groundnut shelling, cotton ginning, dal milling, rice hulling, fruit pulping, milk chilling, etc.

Alternate Market Linkages

12.28 Roads, transport, power and water provide critical linkages in support of production-based activities. Social services like health, education, etc. contribute to improvements in the quality of rural life. State Governments should prioritise infrastructure planning, use of funds of the National Rural Employment Guarantee Programme (NREGP) for building critical infrastructure and encourage community participation in creation and maintenance of assets.

Reducing Vulnerability

Risk Mitigation through Non-financial Channels

12.29 A vast majority of poorer households in India are exposed to high levels of risk and considered as not insurable at reasonable levels of premium. For example, if a dry land farmer loses most of his crop every two years out of five then the insurance premium for him has to be 40%, even if administrative charges are waived. The Committee is of the view that before providing insurance to such house holds, their risk levels need to be mitigated. This can be done through a variety of measures such as soil and water conservation, watershed development, installing protective irrigation and by using appropriate agronomic practices all the way from ploughing techniques to seed selection and timely farm operations. In the case of livestock rearers, risks can be reduced by proper herd management practices and mass vaccination for example against foot and mouth disease. It is only after this type of investments have reduced the risks in farming that the private expense in buying insurance can be affordable.

Calamity Relief Fund

12.30 Repeated natural calamities and consequent rescheduling of bank loans take the debt burden beyond the repaying capacity of farmers. There is a need for the creation of a National Calamity Fund to address the problems of farmers in distress districts. Further, the subsidy on crop insurance may be directed more effectively towards the disadvantaged sectors.

Managing Price Risks through Warehouse Receipts and Commodity Derivatives

12.31 Apart from the physical risks which impact crop yields, farmers also suffer from price risks. In bumper years, their harvest fetches low prices. In order to hedge against such price risks the right instrument is commodity derivatives, particularly options in which a farmer can be assured of selling his produce at a certain price in future.

12.32 The Committee also noted that the Indian farmer is highly attuned to dealing in spot markets, traditionally known as Mandis, where the commodity is exchanged for cash. The Committee therefore supports any initiatives towards improving the transactional efficiency of spot markets.

12.33 The Committee noted that several multi-commodity exchanges have come up in the last few years and that they are registering a large turn over. This enables farmers to discover the future price and take decisions related to crop selection. The Committee is supportive of such initiatives.

12.34 However, the Committee noted the fact that a vast majority of financially excluded farmers have only small marketable surplus of any commodity and thus cannot benefit from the vibrant commodity exchanges, where the minimum traded lot is much larger than what the individual farmer has to offer. In order to extend the benefits of derivative exchanges to excluded farmers, aggregation mechanism such as cooperatives need to come up.

12.35 In the interim, financial instruments such as warehouse receipts and post-harvest credit can be offered so that farmers can avoid distress sales. The passage of the Warehousing (Development and Regulation) Bill, 2005 by Parliament is likely to open up a number of avenues for farmers to mitigate their price risks by encashing stock pledged in a warehouse to meet their cash needs, while waiting for the right price. The Committee is supportive of efforts to establish a chain of authorized warehouses throughout rural India, to provide such services, particularly when such warehouses are linked to PACS.

Organising the Unorganised producers

12.36 The Committee noted that financial services are in the nature of public goods. In order for it to be sustainable, banks need to aggregate the credit demand from the small borrowers. The celebrated mechanism for this is the SHG of which there are now more than 2.9 million in India linked with banks.

12.37 Another well known mechanism for collective action is commodity cooperatives. There is no better example than the dairy producers cooperative societies established by the NDDB.

12.38 The Committee recommends the establishment of similar commodity cooperatives to cover a large number small and marginal producers all over the country. The effort for bringing the producers together can be undertaken by specialized agencies like NDDB and suitable NGOs, while the cost for this should be defrayed by either the Government or by the banks, or a combination thereof.

12.39 The Financial Inclusion Fund cannot be used for a better purpose than supporting a competent and committed agency to organise commodity producer cooperatives in areas such as large cardamom in Sikkim, lac in tribal areas of Eastern Madhya Pradesh, Tasar in Northern Jharkand and seaweed in coastal Andhra Pradesh.

12.40 Commodity production is still a relatively private good. But protection of forests, regeneration of degraded communal pastures or harvesting of rainwater, are pure public goods. The Committee notes that there are several schemes such as joint forest management and the national watershed development programme, under which such activities can be encouraged. Even management of irrigation through canal cooperatives is possible as has been done in several parts of Gujarat and Bihar.

12.41 The Committee endorses Government programmes such as the *Velugu* programme which promote organizing the unorganized producers and recognizes that this cannot happen without the social intermediate of competent and committed NGOs. The legitimate expenses of such intermediaries need to be met. Initially, banks can lend to groups based on considerations of viability; but this will eventually lead to individual lending as individual producers grow. This is the slow and steady process that the Committee recommends to build true financial inclusion.

Chapter – 13

International experiences in Financial Inclusion

Key Learning Areas

13.01 An interesting feature which emerges from the international practice is that the more developed a society is, the greater is the thrust on empowerment of the common person and low-income groups.

13.02 The experiences in financial inclusion are unique to each country. Only limited country-wise experiences are documented and available in public domain. Hence, for the purpose of drawing lessons on financial inclusion, restricted survey of select country experiences are drawn. An attempt has been made in the following paragraphs to categorise these learnings over a few broad parameters :

Products (including Credit Side) :

- Basic Banking Account (BBA),
- Post Office Card Account (POCA) – (United Kingdom - UK; USA),
- Piloting of concept of Savings Gateway (Government funded match of all money saved by those on low income employment, up to a certain limit. Government is making a matching contribution of up to a maximum of £ 25 per month) - (UK),
- Credit unions offered functional flexibility for providing affordable credit with simultaneous tightening of legal provision to ensure investor safety (UK),
- Free encashment of Government cheques (even for non-customers) – (Canada),
- “MZANSI” – a low cost card-based savings account with easy availability at accessible outlets like merchant points-of-sale, post offices, etc. (South Africa),
- Introduction of a savings based demand driven sustainable microfinance programme called PATMIR where savings have precedence over credit (Mexico),
- Product differentiation by end-use and target segments (Bangladesh – Grameen Bank).

Demand Side :

- Developing proposals for delivering a significant increase in the capacity of free face-to-face money advice targeted in areas of high financial exclusion (UK),
- Recognition that the most financially excluded would benefit from face to face money advice and set up by Government of a support fund of £ 45 million for the same (UK),
- Banks contributing to a Money Advice Trust (UK),
- Face to face money advice provided by identified counseling points, viz., citizen advice bureaus, community development groups, etc. (UK).

Outreach Considerations / Sustainability Aspects :

- Set up of a Financial Inclusion Fund with corpus of £ 120 million to offer 3-way access to banking services, affordable credit and money advice (UK),
- Set up of Financial Inclusion Task Force for monitoring (UK),
- Formulation of enabling legislation : Community Reinvestment Act (CRA) prohibits discrimination by banks against low and moderate-income households

- (USA); the legislation on Access to Basic Banking Services Regulations ensures that all citizens could obtain personal bank accounts without any difficulty (Canada); the Bank Act makes the access to bank accounts a legal right (France),
- MoU between the Federal Government and financial institutions on financial inclusion to ensure the access to affordable banking services by all citizens (Canada),
 - Benevolent regulation that enables a level playing field for all entities in micro finance from a compliance and regulatory perspective. Subsidies, promotional schemes, etc. were avoided and the range of financial products was broadened (Bolivia),
 - Regulatory framework along with strengthening institutional capacity, supervision thru' autonomous supervisory committees (Mexico),
 - Institutional restructuring coupled with deregulation of the banking sector and removal of restrictions on credit and interest rates. Supervision delegated while building mainline supervisory capacity in Bank of Indonesia (BI) - (Indonesia).

Delivery Mechanisms :

- Sensitising HR by promoting awareness, providing information and imparting training (UK),
- Support to financial sector development in a three step process : Undertaking a financial sector assessment, adoption of a national level inclusion plan and finalizing strategy for its implementation by various stakeholders and hand-holding the institutions while implementing the plan adopted (Regional programme : Building Inclusive Financial Sectors in Africa - BIFSA),
- Existing rural outlets converted to commercial units (BRI model – Indonesia).

Commonalities Observed in the Various Approaches Applicable in the Indian Context :

- Identification and geographical demarcation of excluded areas - and segments of society - formulating suitable policy to facilitate inclusion,
- Regulation is a must, even if it is “regulation by exception”,
- Strategy to be adopted thru' interaction with stakeholders,
- Inclusive efforts have a cost - to be met by Government and banks,
- Institutional reforms are a must - for only strong institutions can serve social mandate in full,
- Effective participation and coordination among Government, private service providers, financing banks and members of civil societies,
- Adopting technology to widen outreach in excluded areas,
- Enacting legislation mandated to increase levels of inclusion,
- Product development and differentiation to meet the varying demands of excluded segments,
- Financial counseling and advisory services thru' identified touch points,
- Improving absorptive capacity of excluded segments.

For country-wise details, please see Annexure X

Chapter – 14

Conclusion

14.01 The financial system in India has grown rapidly in the last three decades and more. The functional and geographical coverage of the system is truly impressive. Nevertheless, data do show that there is exclusion and that poorer sections of the society have not been able to access adequately financial services from the organized financial system. There is an imperative need to modify the credit and financial services delivery system to achieve greater inclusion. The implementation of the recommendations made in this Report could go a long way to modify particularly the credit delivery system of the banks and other related institutions to meet the credit requirements of marginal and sub-marginal farmers in the rural areas in a fuller measure. However, creating an appropriate credit delivery system is only a necessary condition. This needs to be supplemented by efforts to improve the productivity of small and marginal farmers and other entrepreneurs so that the credit made available can be productively employed. While banks and other financial institutions can also take some efforts on their own to improve the absorptive capacity of the clients, it is equally important for Government at various levels to initiate actions to enhance the earnings capacity of the poorer sections of the society. The two together can bring about the desired change of greater inclusion quickly.

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ANNEXURES

ANNEXURE I

Districts where the Rural & Semi-urban per Branch Population is more than 19,272 and their Corresponding Credit Gap is more than 95% (2005)

Sr.	State/ Union Territory	District	CD Ratio Ru+SU+ Ur+Metro*	Ru+SU -Per Office Data			
				Credit Accounts	Adult population	Adults not having bank loans	%age of adults not having bank loans
1	ARUNACHAL PRADESH	CHUNGLANG	19.0	475	32984	32509	98.6
2	ARUNACHAL PRADESH	DIBANG VALLEY	11.7	360	30359	29999	98.8
3	ARUNACHAL PRADESH	EAST KAMENG	13.0	218	30075	29857	99.3
4	ARUNACHAL PRADESH	LOHIT	16.0	419	25164	24745	98.3
5	ARUNACHAL PRADESH	TIRAP	9.8	329	26384	26056	98.8
6	ASSAM	BARPETA	45.8	878	30946	30068	97.2
7	ASSAM	BONGAIGAON	41.8	701	25946	25246	97.3
8	ASSAM	CACHAR	33.9	454	30510	30056	98.5
9	ASSAM	DARRANG	52.3	820	33453	32633	97.6
10	ASSAM	DHEMAJI	35.3	542	36660	36119	98.5
11	ASSAM	DHUBRI	33.4	702	45747	45046	98.5
12	ASSAM	DIBRUGARH	23.6	467	22466	22000	97.9
13	ASSAM	GOALPARA	45.2	742	25593	24851	97.1
14	ASSAM	HAILAKANDI	24.6	506	31134	30628	98.4
15	ASSAM	JORHAT	33.7	637	27360	26723	97.7
16	ASSAM	KAKROJHAR	35.5	1073	39479	38406	97.3
17	ASSAM	KAMRUP	36.1	775	25085	24310	96.9
18	ASSAM	KARIMGANJ	28.2	414	24408	23993	98.3
19	ASSAM	LAKHIMPUR	37.5	512	20611	20099	97.5
20	ASSAM	MORIGAON	48.2	778	30209	29431	97.4
21	ASSAM	NAGAON	34.9	613	28927	28314	97.9
22	ASSAM	NALBARI	57.0	1071	27214	26142	96.1
23	ASSAM	SIBSAGAR	31.3	606	19759	19153	96.9
24	ASSAM	SONITPUR	45.4	808	22621	21813	96.4
25	BIHAR	ARARIA	51.1	868	33671	32803	97.4
26	BIHAR	AURANGABAD	24.3	794	26104	25311	97.0
27	BIHAR	BANKA	36.8	725	31981	31256	97.7
28	BIHAR	BEGUSARAI	35.1	729	24258	23529	97.0
29	BIHAR	BHAGALPUR	32.2	645	26569	25924	97.6
30	BIHAR	BHOJPUR	20.4	1110	25234	24124	95.6
31	BIHAR	BUXAR	26.8	1117	22197	21080	95.0
32	BIHAR	DARBHANGA	23.9	472	27927	27455	98.3
33	BIHAR	GAYA	22.9	710	25535	24825	97.2
34	BIHAR	GOPALGANJ	22.7	751	25460	24709	97.0
35	BIHAR	JAMUI	25.3	672	27373	26701	97.5
36	BIHAR	JEHANABAD	19.8	711	25466	24756	97.2
37	BIHAR	KAIMUR	41.9	1109	22378	21268	95.0
38	BIHAR	KATIHAR	57.7	908	30341	29433	97.0
39	BIHAR	KHAGARIA	33.7	790	28709	27919	97.2
40	BIHAR	KISHANGANJ	44.9	870	29068	28198	97.0
41	BIHAR	LAKHISARAI	23.2	664	24670	24005	97.3
42	BIHAR	MADHEPURA	41.9	669	29001	28332	97.7
43	BIHAR	MADHUBANI	27.2	522	26482	25961	98.0

Sr.	State/ Union Territory	District	CD Ratio Ru+SU+ Ur+Metro*	Ru+SU -Per Office Data			
				Credit Accounts	Adult population	Adults not having bank loans	%age of adults not having bank loans
44	BIHAR	MUNGER	19.4	737	23232	22495	96.8
45	BIHAR	MUZAFFARPUR	28.6	700	27640	26940	97.5
46	BIHAR	NALANDA	22.3	759	23975	23216	96.8
47	BIHAR	NAWADA	18.6	835	27825	26991	97.0
48	BIHAR	PASCHIMI CHAMPARAN	51.1	782	27133	26350	97.1
49	BIHAR	PATNA	25.5	503	22497	21994	97.8
50	BIHAR	PURBI CHAMPARAN	35.1	685	27611	26926	97.5
51	BIHAR	PURNIA	48.0	811	39281	38470	97.9
52	BIHAR	ROHTAS	29.7	1199	25273	24073	95.3
53	BIHAR	SAHARSA	37.7	722	28124	27402	97.4
54	BIHAR	SAMASTIPUR	33.9	677	24856	24178	97.3
55	BIHAR	SARAN	21.4	813	27531	26718	97.0
56	BIHAR	SHEIKHPURA	23.0	822	25709	24887	96.8
57	BIHAR	SHEOHAR	21.2	472	32666	32195	98.6
58	BIHAR	SITAMARHI	35.3	723	30241	29518	97.6
59	BIHAR	SIWAN	14.2	567	24004	23437	97.6
60	BIHAR	SUPAUL	33.8	655	28095	27440	97.7
61	BIHAR	VAISHALI	24.8	742	27674	26932	97.3
62	CHHATTISGARH	BASTAR	35.2	743	23461	22718	96.8
63	CHHATTISGARH	BILASPUR	26.2	578	28668	28090	98.0
64	CHHATTISGARH	DANTEWADA	110.7	588	24222	23634	97.6
65	CHHATTISGARH	DHAMTARI	48.7	845	27186	26341	96.9
66	CHHATTISGARH	DURG	41.0	521	22924	22403	97.7
67	CHHATTISGARH	JANJGIR-CHAMPA	33.2	611	25805	25193	97.6
68	CHHATTISGARH	JASHPUR	22.3	506	21638	21132	97.7
69	CHHATTISGARH	KANKER	44.6	1062	33393	32330	96.8
70	CHHATTISGARH	KAWARDHA	35.9	698	29987	29289	97.7
71	CHHATTISGARH	KORBA	37.6	683	23435	22752	97.1
72	CHHATTISGARH	MAHASAMUND	54.2	849	25047	24198	96.6
73	CHHATTISGARH	RAIGARH	48.5	745	21100	20355	96.5
74	CHHATTISGARH	RAIPUR	54.9	541	25538	24997	97.9
75	CHHATTISGARH	RAJNANDGAON	45.3	576	21920	21344	97.4
76	CHHATTISGARH	SURGUJA	34.9	686	20233	19547	96.6
77	DADRA & NAGAR HAVELI	DADRA&NAGAR HAVELI	34.8	476	20167	19691	97.6
78	GUJARAT	AHMADABAD	60.2	388	20347	19959	98.1
79	GUJARAT	BANAS KANTHA	47.3	748	29436	28688	97.5
80	GUJARAT	BHAVNAGAR	37.7	762	20347	19585	96.3
81	GUJARAT	DAHOD	24.7	752	28132	27380	97.3
82	GUJARAT	DANGS	20.6	1076	24878	23802	95.7
83	GUJARAT	NARMADA	29.5	629	22845	22216	97.2
84	GUJARAT	PANCH MAHALS	28.1	663	24930	24267	97.3
85	HARYANA	HISAR	85.1	767	23149	22382	96.7
86	HARYANA	JIND	84.0	951	20773	19821	95.4
87	HARYANA	KARNAL	95.0	848	21709	20861	96.1
88	HARYANA	PANIPAT	90.8	761	21398	20636	96.4

Sr.	State/ Union Territory	District	CD Ratio Ru+SU+ Ur+Metro*	Ru+SU -Per Office Data			
				Credit Accounts	Adult population	Adults not having bank loans	%age of adults not having bank loans
89	HARYANA	SONIPAT	32.4	657	20928	20271	96.9
90	JHARKHAND	CHATRA	19.1	927	25582	24655	96.4
91	JHARKHAND	DHANBAD	19.2	694	31680	30986	97.8
92	JHARKHAND	GARHWA	27.0	823	29065	28243	97.2
93	JHARKHAND	GIRIDIH	28.0	682	21160	20478	96.8
94	JHARKHAND	GUMLA	20.0	594	21126	20532	97.2
95	JHARKHAND	HAZARIBAG	22.1	867	22606	21740	96.2
96	JHARKHAND	KODERMA	21.9	786	20488	19702	96.2
97	JHARKHAND	LOHARDAGGA	27.5	1008	22872	21863	95.6
98	JHARKHAND	PAKUR	29.1	740	20228	19488	96.3
99	JHARKHAND	PALAMAU	20.3	638	21730	21093	97.1
100	JHARKHAND	RANCHI	28.3	759	20880	20122	96.4
101	JHARKHAND	SAHEBGANJ	27.0	812	21056	20244	96.1
102	MADHYA PRADESH	BALAGHAT	43.7	502	20333	19831	97.5
103	MADHYA PRADESH	BARWANI	56.4	627	24986	24358	97.5
104	MADHYA PRADESH	BETUL	33.2	661	23308	22647	97.2
105	MADHYA PRADESH	BHIND	45.0	555	32959	32405	98.3
106	MADHYA PRADESH	CHHATARPUR	40.2	807	23019	22211	96.5
107	MADHYA PRADESH	DAMOH	47.9	799	20854	20055	96.2
108	MADHYA PRADESH	DINDORI	38.1	421	25224	24803	98.3
109	MADHYA PRADESH	EAST NIMAR	46.3	660	21201	20541	96.9
110	MADHYA PRADESH	GUNA	75.7	805	24072	23267	96.7
111	MADHYA PRADESH	HARDA	73.2	926	19814	18888	95.3
112	MADHYA PRADESH	JABALPUR	37.7	561	21274	20713	97.4
113	MADHYA PRADESH	JHABUA	32.9	731	26567	25836	97.2
114	MADHYA PRADESH	KATNI	41.0	454	22150	21697	98.0
115	MADHYA PRADESH	MANDLA	35.6	524	20230	19706	97.4
116	MADHYA PRADESH	MANDSAUR	69.7	808	21601	20794	96.3
117	MADHYA PRADESH	MORENA	72.5	604	31951	31347	98.1
118	MADHYA PRADESH	PANNA	33.9	610	24477	23867	97.5
119	MADHYA PRADESH	RATLAM	55.3	667	23966	23299	97.2
120	MADHYA PRADESH	REWA	29.3	559	23997	23438	97.7
121	MADHYA PRADESH	SAGAR	44.7	729	26437	25708	97.2
122	MADHYA PRADESH	SATNA	37.7	626	20247	19621	96.9
123	MADHYA PRADESH	SEONI	43.9	586	20767	20181	97.2
124	MADHYA PRADESH	SHAHDOL	32.5	600	23758	23158	97.5
125	MADHYA PRADESH	SHAJAPUR	96.5	907	21235	20328	95.7
126	MADHYA PRADESH	SHEOPUR	72.6	765	31976	31211	97.6
127	MADHYA PRADESH	SHIVPURI	39.0	642	30571	29930	97.9
128	MADHYA PRADESH	SIDHI	15.0	591	25708	25117	97.7
129	MADHYA PRADESH	TIKAMGARH	33.4	806	22523	21717	96.4
130	MADHYA PRADESH	VIDISHA	89.4	744	20471	19727	96.4
131	MADHYA PRADESH	WEST NIMAR	52.6	720	23199	22479	96.9
132	MAHARASHTRA	AHMADNAGAR	78.5	587	22356	21769	97.4
133	MAHARASHTRA	AURANGABAD	80.6	820	25845	25025	96.8
134	MAHARASHTRA	BID	64.6	825	23309	22484	96.5
135	MAHARASHTRA	BULDHANA	78.9	972	23200	22228	95.8

Sr.	State/ Union Territory	District	CD Ratio Ru+SU+ Ur+Metro*	Ru+SU -Per Office Data			
				Credit Accounts	Adult population	Adults not having bank loans	%age of adults not having bank loans
136	MAHARASHTRA	DHULE	76.0	717	26818	26101	97.3
137	MAHARASHTRA	GADCHIROLI	40.3	662	23919	23257	97.2
138	MAHARASHTRA	GONDIA	53.3	641	23359	22718	97.3
139	MAHARASHTRA	HINGOLI	52.0	1001	27537	26536	96.4
140	MAHARASHTRA	JALGAON	74.0	644	25422	24777	97.5
141	MAHARASHTRA	JALNA	77.6	1148	24743	23595	95.4
142	MAHARASHTRA	KOLHAPUR	83.6	636	21295	20659	97.0
143	MAHARASHTRA	LATUR	69.8	676	23888	23212	97.2
144	MAHARASHTRA	NAGPUR	57.2	678	19967	19290	96.6
145	MAHARASHTRA	NANDED	57.7	926	26185	25259	96.5
146	MAHARASHTRA	NANDURBAR	54.4	607	30898	30292	98.0
147	MAHARASHTRA	NASIK	46.0	636	26366	25730	97.6
148	MAHARASHTRA	OSMANABAD	50.7	632	22194	21562	97.2
149	MAHARASHTRA	PARBHANI	74.9	1130	23181	22051	95.1
150	MAHARASHTRA	WASHIM	75.1	830	20027	19196	95.9
151	MAHARASHTRA	YAVATMAL	58.4	898	24293	23395	96.3
152	MANIPUR	BISHENPUR	113.3	694	45947	45253	98.5
153	MANIPUR	CHANDEL	82.6	546	26092	25547	97.9
154	MANIPUR	CHURACHANDPUR	51.2	647	62819	62172	99.0
155	MANIPUR	IMPHAL EAST	65.6	452	54421	53969	99.2
156	MANIPUR	IMPHAL WEST	36.8	949	45473	44524	97.9
157	MANIPUR	SENAPATI	81.7	513	26049	25536	98.0
158	MANIPUR	TAMENGLONG	85.7	138	24586	24448	99.4
159	MANIPUR	THOUBAL	54.0	384	44609	44225	99.1
160	MANIPUR	UKHRUL	11.0	151	38803	38653	99.6
161	MEGHALAYA	SOUTH GARO HILLS	44.6	354	35448	35094	99.0
162	MIZORAM	LAWNGTLAI	102.7	675	39065	38390	98.3
163	NAGALAND	MOKOKCHUNG	45.6	439	27329	26890	98.4
164	NAGALAND	MON	35.8	634	92078	91444	99.3
165	NAGALAND	PHEK	79.7	473	26176	25703	98.2
166	NAGALAND	TUENSANG	74.8	858	62802	61944	98.6
167	NAGALAND	WOKHA	52.4	399	24409	24009	98.4
168	NAGALAND	ZUNHEBOTO	66.5	423	27193	26770	98.4
169	ORISSA	BHADRAK	59.9	1071	22564	21493	95.3
170	ORISSA	NAWAPARA	44.8	960	19880	18920	95.2
171	RAJASTHAN	ALWAR	83.3	1042	21744	20702	95.2
172	RAJASTHAN	BARMER	57.0	930	29194	28264	96.8
173	RAJASTHAN	BHILWARA	124.6	879	20439	19560	95.7
174	RAJASTHAN	DAUSA	52.0	811	23809	22998	96.6
175	RAJASTHAN	DHOLPUR	78.5	1093	29624	28531	96.3
176	RAJASTHAN	JAIPUR	98.2	624	21036	20411	97.0
177	RAJASTHAN	JALOR	52.8	819	25764	24945	96.8
178	RAJASTHAN	JHALAWAR	65.4	751	20004	19252	96.2
179	RAJASTHAN	JHUNJHUNU	32.1	947	21505	20558	95.6
180	RAJASTHAN	JODHPUR	59.3	778	26156	25379	97.0
181	RAJASTHAN	KARAULI	47.5	838	29157	28319	97.1
182	RAJASTHAN	NAGAU	43.8	693	23515	22823	97.1

Sr.	State/ Union Territory	District	CD Ratio Ru+SU+ Ur+Metro*	Ru+SU -Per Office Data			
				Credit Accounts	Adult population	Adults not having bank loans	%age of adults not having bank loans
183	RAJASTHAN	SIKAR	40.0	910	23028	22117	96.0
184	RAJASTHAN	UDAIPUR	43.8	536	24338	23802	97.8
185	UTTAR PRADESH	ALLAHABAD	26.7	784	32450	31666	97.6
186	UTTAR PRADESH	AMBEDKAR NAGAR	28.6	927	29321	28394	96.8
187	UTTAR PRADESH	AURAIYA	25.7	616	24620	24004	97.5
188	UTTAR PRADESH	AZAMGARH	19.2	739	23232	22493	96.8
189	UTTAR PRADESH	BAGHPAT	47.7	1110	26870	25760	95.9
190	UTTAR PRADESH	BAHRAICH	42.1	816	27595	26778	97.0
191	UTTAR PRADESH	BALLIA	18.3	611	21609	20998	97.2
192	UTTAR PRADESH	BALRAMPUR	30.4	1003	26453	25450	96.2
193	UTTAR PRADESH	BARA BANKI	43.2	1000	21173	20174	95.3
194	UTTAR PRADESH	BAREILLY	44.7	822	28586	27764	97.1
195	UTTAR PRADESH	BASTI	42.3	960	24943	23983	96.2
196	UTTAR PRADESH	BIJNOR	52.1	1040	24801	23761	95.8
197	UTTAR PRADESH	BUDAUN	61.2	1050	28815	27764	96.4
198	UTTAR PRADESH	BULANDSHAHR	36.0	953	25163	24210	96.2
199	UTTAR PRADESH	CHANDAULI	33.4	887	31278	30391	97.2
200	UTTAR PRADESH	DEORIA	23.6	866	27837	26971	96.9
201	UTTAR PRADESH	ETAH	44.8	1053	26394	25341	96.0
202	UTTAR PRADESH	ETAWAH	33.0	823	24985	24162	96.7
203	UTTAR PRADESH	FAIZABAD	31.0	872	34580	33708	97.5
204	UTTAR PRADESH	FARRUKHABAD	39.0	984	26965	25981	96.4
205	UTTAR PRADESH	FATEHPUR	26.7	659	24888	24229	97.4
206	UTTAR PRADESH	FIROZABAD	40.9	1106	28062	26957	96.1
207	UTTAR PRADESH	GAUTAM BUDDHA NAGAR	29.0	979	24953	23974	96.1
208	UTTAR PRADESH	GHAZIABAD	48.8	848	24233	23385	96.5
209	UTTAR PRADESH	GHAZIPUR	19.9	654	22319	21665	97.1
210	UTTAR PRADESH	GONDA	31.1	1030	25721	24691	96.0
211	UTTAR PRADESH	GORAKHPUR	28.9	965	27757	26792	96.5
212	UTTAR PRADESH	HAMIRPUR	70.1	975	19867	18891	95.1
213	UTTAR PRADESH	HARDOI	46.3	1396	28645	27249	95.1
214	UTTAR PRADESH	JAUNPUR	19.1	821	25600	24779	96.8
215	UTTAR PRADESH	JHANSI	35.9	1172	24668	23497	95.3
216	UTTAR PRADESH	KANAUJ	51.9	1243	25541	24298	95.1
217	UTTAR PRADESH	KANPUR NAGAR	41.3	818	60570	59752	98.6
218	UTTAR PRADESH	KAUSHAMBI	23.9	673	29230	28557	97.7
219	UTTAR PRADESH	KHERI	53.6	962	26835	25874	96.4
220	UTTAR PRADESH	KUSHI NAGAR	38.7	1168	32698	31530	96.4
221	UTTAR PRADESH	LUCKNOW	32.4	789	23673	22884	96.7
222	UTTAR PRADESH	MAHARAJGANJ	37.3	1193	29855	28663	96.0
223	UTTAR PRADESH	MAINPURI	41.9	1097	24858	23761	95.6
224	UTTAR PRADESH	MAU	21.2	687	26188	25501	97.4
225	UTTAR PRADESH	MEERUT	53.8	1083	22260	21177	95.1
226	UTTAR PRADESH	MIRZAPUR	39.6	1161	28018	26858	95.9
227	UTTAR PRADESH	MORADABAD	66.0	1279	25432	24153	95.0
228	UTTAR PRADESH	MUZAFFARNAGAR	80.8	1062	24198	23136	95.6

Sr.	State/ Union Territory	District	CD Ratio Ru+SU+ Ur+Metro*	Ru+SU -Per Office Data			
				Credit Accounts	Adult population	Adults not having bank loans	%age of adults not having bank loans
229	UTTAR PRADESH	PILIBHIT	66.0	963	25784	24821	96.3
230	UTTAR PRADESH	PRATAPGARH	20.6	659	22620	21961	97.1
231	UTTAR PRADESH	RAI BARELI	26.4	1034	25501	24467	95.9
232	UTTAR PRADESH	RAMPUR	72.2	1120	22272	21152	95.0
233	UTTAR PRADESH	SANT KABIR NAGAR	27.8	852	28535	27683	97.0
234	UTTAR PRADESH	SANT RAVIDAS NAGAR	50.0	650	27198	26549	97.6
235	UTTAR PRADESH	SHAHJAHANPUR	53.4	818	23436	22618	96.5
236	UTTAR PRADESH	SHRAVASTI	42.9	839	23636	22797	96.5
237	UTTAR PRADESH	SIDHARTHANAGAR	29.6	843	26993	26150	96.9
238	UTTAR PRADESH	SITAPUR	41.0	802	26496	25694	97.0
239	UTTAR PRADESH	SONBHADRA	31.0	979	23699	22721	95.9
240	UTTAR PRADESH	SULTANPUR	26.1	1093	24273	23180	95.5
241	UTTAR PRADESH	UNNAO	25.1	1181	27453	26273	95.7
242	UTTAR PRADESH	VARANASI	28.0	666	31994	31328	97.9
243	WEST BENGAL	BANKURA	27.4	979	20615	19637	95.3
244	WEST BENGAL	BARDDHAMAN	25.0	766	20236	19470	96.2
245	WEST BENGAL	DAKSHIN DINAJPUR	49.4	1224	26118	24894	95.3
246	WEST BENGAL	HAORA	26.0	729	23200	22472	96.9
247	WEST BENGAL	JALPAIGURI	29.1	840	24180	23340	96.5
248	WEST BENGAL	KOCH BIHAR	52.3	1144	23594	22449	95.2
249	WEST BENGAL	MALDAH	42.4	1053	25426	24373	95.9
250	WEST BENGAL	MURSHIDABAD	32.9	866	29842	28975	97.1
251	WEST BENGAL	NADIA	29.2	1289	28164	26874	95.4
252	WEST BENGAL	NORTH 24 PARGANAS	18.6	999	22653	21654	95.6
253	WEST BENGAL	PASCHIM MEDINIPUR	31.6	854	22102	21248	96.1
254	WEST BENGAL	PURULIYA	20.0	785	23493	22708	96.7
255	WEST BENGAL	SOUTH 24 PARGANAS	20.1	837	29001	28163	97.1
256	WEST BENGAL	UTTAR DINAJPUR	52.6	1350	32944	31593	95.9

ANNEXURE II

State-wise SHG credit linkage by RRBs : March 2006					
S. no.	State	Cum. no. of SHGs credit linked (RRBs)	Cum no. of SHGs credit linked by all agencies	% SHGs credit linked (RRBs)	Cum. bank loan disbursed - RRBs(Rs. cr.)
1	Haryana	2510	4867	52%	14.97
2	Himachal Pradesh	3671	22920	16%	13.21
3	Punjab	560	4561	12%	3.36
4	J & K	499	2354	21%	1.33
5	Rajasthan	38532	98171	39%	92.77
6	New Delhi	0	224		0
	Northern Region	45772	133097	34%	125.64
7	Assam	31528	56449	56%	45.12
8	Meghalaya	198	735	27%	0.35
9	Nagaland	28	422	7%	0.86
10	Tripura	1516	1996	76%	2.14
11	Arunachal Pradesh	127	346	37%	0.57
12	Mizoram	812	974	83%	4.63
13	Manipur	899	1468	61%	3.41
14	Sikkim	0	127		0.00
	North Eastern Region	35108	62517	56%	57.08
15	Bihar	26188	46221	57%	53.52
16	Jharkhand	9299	30819	30%	24.46
17	Orissa	86256	180896	48%	221.69
18	West Bengal	37909	136251	28%	68.05
19	A & N Islands	0	164		0.00
	Eastern Region	159652	394351	40%	367.72
20	Chattisgarh	14571	31291	47%	15.26
21	Madhya Pradesh	20453	57125	36%	46.35
22	Uttaranchal	2668	17588	15%	18.35
23	Uttar Pradesh	90698	161911	56%	272.18
	Central Region	128390	267915	48%	352.14
24	Gujarat	6309	34160	18%	13.87
25	Maharashtra	28115	131470	21%	102.24
26	Goa	0	624		0.00
	Western Region	34424	166254	21%	116.11
27	Andhra Pradesh	190120	587238	32%	1342.46
28	Karnataka	81839	224928	36%	384.13
29	Kerala	9055	86988	10%	37.42
30	Tamil Nadu & Puduchery	55664	315277	18%	539.43
	Southern Region	336678	1214431	28%	2303.44
	Grand Total	740024	2238565	33%	3322.13

ANNEXURE III

Major Results of Impact Assessments on the SHG - Bank Linkage Programme

1. SHG - Bank Linkage Programme for Rural Poor (2002) – An Impact Assessment (V. Puhazhendhi & K.C.Badatya, NABARD)

The study was based on primary details collected from 115 members of 60 SHGs spread over 3 States. The socio-economic conditions of the members were compared between pre and post SHG situations to quantify the impact. The study findings concluded that the SHG - Bank Linkage Programme has made significant contribution to social and economic improvement of the member households of SHGs.

There was a significant increase in the asset structure, mean annual savings, average loan per member, overall repayment percentage, average annual net income, employment per sample households. Availing loans from moneylenders and other informal sources with higher interest rate was significantly reduced due to SHG intervention. There was remarkable improvement in social empowerment of SHG members (more than 90% are women) in terms of self-confidence, involvement in decision-making, better communication, etc.

Major Findings

- Structure and conduct of SHGs especially with reference to size, homogeneity, conduct and attendance of meetings, record keeping, etc., was broadly in conformity with the guideline of the programme.
- The SC / ST and backward class constituted 83% of the total sample and coverage of this social group has shown increasing trend during the recent years.
- While there was no change in asset structure in 52% of the sample households, about 45% of them registered increase in assets between pre and post SHG situations. The increase in value of assets that included livestock and consumer durable was from Rs.4,498 to Rs. 5,827 registering an increase of 30% after joining the group.
- Varied saving products that are suitable for the rural poor were made available for SHG members that facilitated increased rate of saving among them. Mean annual savings were increased from Rs. 952 to Rs. 1,863 registering two fold increase.
- Institutional credit deepening and widening among the rural poor were achieved to a greater extent. The average loan per member during post SHG situation was Rs. 5,122, which was about 123% more than the pre SHG situation. Availing loans from moneylenders and other informal sources with higher interest rate was significantly reduced due to SHG intervention. The average annual interest paid by the members from different sources was reduced from 81% to 31%.
- There was perceptible change in the loaning pattern between pre and post SHG situations. Consumption oriented loans were replaced by production oriented loans during post SHG situations which was mainly due to SHGs and training provided under the programme.
- Recovery performance of loans from members to SHGs worked out to 95% where as it was 86.6% from SHGs to banks. The overall repayment percentage improved from 86% to 95% between pre and post SHG situations with an perceptible increase in repayment of loans from banks by 22 percentage points.

- The average annual net income per sample households was increased to Rs. 15,184, which was about 23% higher than in the pre SHG situations. The incremental income was contributed mainly by farm activities (54%) followed by non-farm activities (36%).
- Employment per sample households increased by 34% from 303 to 405 person days between pre and post-SHG situations.
- There was remarkable improvement in social empowerment of SHG members in terms of self-confidence, involvement in decision-making, better communication, etc.
- NGO promoted groups edge over BANK promoted groups on coverage of more weaker sections, spreading programme more in inaccessible areas, improvement in assets, savings, income and employment generations, capacity building and human resource development, etc. BANK promoted groups performed relatively more in institutional loan repayment. There is greater scope for BANK promoted groups for improving the conduct of SHGs and capacity building of its members.
- Sustainability of SHGs was well established through the better performance of older groups than the recently formed groups in terms of increased value of assets and saving rate, better access of institutional loans, higher rate of repayment of loans, elimination of informal sources and impressive social empowerment.

Recommendations

- For greater acceleration of rate of economic empowerment, future strategy must focus more and more on training and capacity building of members besides ensuring adequate linkage supports.
- SHGs role may further be enhanced through its involvement in developmental programmes implemented in the areas.
- While expanding the programme for wider coverage, efforts also need to be focused on strengthening the existing groups and institutional building such as federal structures.

2. Micro Finance for Rural People - An Impact Evaluation (2000)

(V. Puhazhendi & K. J. S. Satyasai, NABARD)

This study by NABARD covered 560 SHG member households from 223 SHGs spread over 11 States. Important findings from the study indicate that there have been perceptible and wholesome changes in the living standards of the SHG members, in terms of ownership of assets, increase in savings and borrowing capacity, income generating activities and in income levels. Some of the major findings of the study are presented here :

- Member households: landless agricultural labourers (31%); marginal farmers (23%); small farmers (29%); others (17%).
- Average value of assets (land, house, livestock and consumer durables etc.) per household increased by 13 % from Rs. 63,000 in pre-SHG stage to Rs. 71,000 in post-SHG stage. Land was the major asset with a share of 44% of the value of assets.
- About 62% of the households reported increase by about 25% in assets from pre to post-SHG situation.
- Housing conditions generally improved with a shift from kuchha (mud walls, thatched roofs) to pucca (brick walls, tiled roofs) housing.

- Almost all of the members developed saving habit in the post-SHG situation as against only 23% of households who had this habit in the pre-SHG situation.
- Average annual savings per household registered over threefold increase from Rs. 460 to Rs. 1,444.
- The average borrowings / year / household increased from Rs. 4,282 to Rs. 8,341.
- The share of consumption loans declined from 50% to 25%. About 70% of loans taken in post-SHG situation were for income generating purposes.
- Annualised interest rates on loans from SHGs to members were in the 12% to 24 % range.
- Overall loan repayments improved from 84% to 94% between the two periods with an impressive improvement of 29 percentage points in the repayment of loans to banks.
- Average net income / household increased from Rs. 20,177 to Rs.26,889, or by about 33%.
- About 43% of the incremental income generated was from non farm sector activities followed by farm (28%) and off-farm (21%) activities.
- About 74% of the sample members had income below Rs. 22,500 in pre-SHG situation. During the post-SHG period, the proportion came down to 57%.
- Employment increased by 18% from 318 mandays to 375 mandays per household between pre- and post-SHG situations.

The involvement in the group significantly contributed in improving the self-confidence of the members. The feeling of self-worth and communication with others improved after association with the SHGs.

The members were relatively more assertive in confronting social evils and problem situations. As a result, there was a fall in the incidence of family violence

3. Self Help Groups in India - A Study of Lights and Shades

(Kimberley Wilson and Grances Sinha, EDA Rural Systems Pvt. Ltd.)

The study was based on a sample of 214 SHGs in 108 villages of nine districts in four states - Andhra Pradesh (60 SHGs), Karnataka (57 SHGs), Orissa (50 SHGs), Rajasthan (53 SHGs) credit linked to banks before March 2000.

Findings

Light

- SHG members reflect a diverse membership covering different social and economic categories, including the poor.
- According to an objective household wealth ranking, approximately correlated to the national poverty line, 51% of members are poor (below the poverty line); another 32% are “borderline” (above the poverty line but vulnerable to risk). SCs and STs, recognised as structurally poor, are 55% of members. Widows, also a vulnerable and under-privileged group, were found to be 10% of SHG members.
- SHG leaders are of all castes, reflecting the caste composition of their group.
- In functioning SHGs, the drop out rate for the two regions combined is under 10% of membership. Almost 50% of the SHGs had no dropouts; one-third had two or fewer dropouts.

- In one out of every four SHGs in the study sample, there is a woman member who ran for local political office (in the *Panchayat* or village council), and in one out of every five SHGs, there is a woman member who has been elected.
- Half the elected women representatives (25 out of 44) were active in the Panchayat, attending meetings regularly, carrying out responsibilities; only seven (16%) turned out to be proxies meaning that their husbands took their place.
- One-third of SHGs have some members from different castes. 20% of groups in fact cross the main hierarchies (between SC / ST and the other castes). This is more likely in NGO promoted SHGs (24% of groups), lower in Government promoted groups and in Andhra Pradesh (12% of groups).
- NGO SHPIs which have village wide development focus make participation across castes a condition of their programme.
- 30% of SHGs in the sample have been involved in community actions like improving community services, trying to stop alcohol sale and consumption, contributing finance and labour for new infrastructure, protecting natural resources etc.
- The number of non-borrowers is quite small - 5% in the southern sample (data available for the previous year), 8% in the northern sample (data since formation of the group).
- Overall, the data shows relatively low standard deviation around the mean for number of loans and amount borrowed by members.
- It is sometimes asked whether group leaders take advantage of their position to obtain a disproportionate share of available credit. The data does not support this overall. In some SHGs (up to 18%), leaders are accessing more credit, especially over a longer time frame (northern data, Orissa particularly). This is known by other group members and is not necessarily seen to be exploitative (or at any rate is not reported as such in group discussions).

Shade

- It seems significant that for women who have been an SHG member for seven years (or more), half are (still) poor, including 13% very poor.
- At group level, SHG membership is not homogeneous by wealth (which affects “equity” issues).
- In nearly half the groups (47%) there are some members related to each other particularly in the family based tribal communities and also in other communities.
- There are barriers inherent in the conditions of membership to a group formed to mediate financial transactions – through regular meetings, savings and loan repayments. Such conditions are difficult for women who migrate for seasonal wage employment, and households with variable or uncertain incomes. Both are economic characteristics of the poor and very poor. They can and do lead to “self-exclusion” if not exclusion by group members or by SHPI staff.
- If a member leaves a SHG, she is in theory entitled to receive back her savings + interest but in practice, in most SHPIs and SHGs, this is not communicated as the norm. In the absence of clear norms, or regular accreditation of accumulated interest, dropouts are not likely to obtain interest due on their savings.
- A significant proportion of sampled groups (40%) have weak records.
- It is the responsibility of SHPIs to have a system for internal verifications as well as arrange for external audits. Nearly all SHPIs in the study (29 out of 35) did

have some verification systems in place, undertaken by SHPI field staff at different periods of time (quarterly, six-monthly, annually). Comparing the data, however, having a system of internal verification does not make much of a difference to record quality, since the quality of such a system as well as the capacity of field staff are also variable.

- Part of the problem lies in the relative complexity of the recording system – the number of records, and the amount of work to record the transactions.
- The reported cases of on-lending by individual members or by the group lending to non-members (18% of the sample) appear to result from supply-driven credit distribution to SHGs - which is increasingly practised as part of target-driven programmes, and sometimes linked to subsidy (as under SGSY).
- In the southern sample, 28% of borrowers were more than 12 months overdue, with higher incidence (38%) amongst very poor borrowers. Group leaders and members alike default on loans (slightly higher incidence among leaders in the southern sample).
- Current practices of recovery, especially in Andhra Pradesh, rely heavily on bullet repayments and the incentive of further loans. This may work up to a point, but is not a healthy strategy as loan sizes increase.
- SHG member involvement in loan decision-making did not translate to their being reasonably well versed with the financial status of their SHGs, and in the absence of financial statements, SHGs (or SHPIs promoting them) cannot monitor their financial position.
- In the majority of groups it is not the case that SHG earnings are high enough to maintain the value of SHG members' capital.

ANNEXURE IV

Cost of Transactions for Small Accounts⁸

The cost of transactions for small credit accounts have been estimated by Central Bank of India and ICICI Bank in September 2006 for the YC Nanda Working Group on Outreach of Institutional Finance and Cooperative Reforms constituted for Eleventh Five Year Plan.

Central Bank of India Study

The Central Bank of India has undertaken cost estimates of credit for amounts up to Rs. 25,000 at five branches for the year ended March 2006. The study accounted the following factors while working out the cost of reaching agriculture credit to the disadvantaged sections :

Branch Level Cost

1. Cost incurred for selection of applicant,
2. Cost incurred for application forms, pre-sanction inspections, processing of applications, documentation, cost of stationery i.e. vouchers, ledgers, etc.,
3. Cost incurred for carrying out post-sanction inspections,
4. Cost incurred for follow-up of advances and monitoring the progress, postage incurred for issue of demand notices, recovery notices, etc.,
5. Proportionate establishment cost, TA/DA of staff, rent on premises, telephone expenses, hiring charges of vehicles for contacting the borrowers for timely repayment and recoveries,
6. Proportionate cost of funds taken from depositors or through borrowings from NABARD,
7. Cost incurred for paying commission to recovery agents, revenue officials for effecting recovery from the defaulters.

Controlling Office Level

1. Cost incurred for formulation of schemes, correspondence, monitoring, inspection and audit,
2. Maintenance of CRR / SLR, investment in RIDF Funds,
3. Cost incurred for write-off accounts where chances of recovery are very remote despite best efforts,
4. Sacrifice in compromised cases,
5. Depreciation cost on hardware, software, AMC Charges for computers in the computerized branches,
6. Depreciation on furniture,
7. Provision on standard and NPA accounts.

Out of the total lending made by the branch the proportionate share of cost incurred for advances made to small farmers, marginal farmers and agricultural laborers for agriculture loans up to Rs. 25,000 has been taken into account.

⁸ Prepared by the Reserve Bank of India.

The break up of transactions cost for the bank is as given in the table below :

Central Bank of India					
Transaction cost of agricultural advances up to Rs. 25,000					
Branch	Region	Agricultural loans up to Rs 25,000	Total expenses	Transaction cost	Transaction cost as % of loans up to Rs 25,000
BISNOOR	HOSHANGABAD	19	3.24	2.7	14.21%
TARA	HOSHANGABAD	12	2.60	1.6	13.33%
BADOPAL	ROHTAK	38	7.10	5.2	13.68%
DAHINA	ROHTAK	31	6.80	3.8	12.26%
DUJANA	ROHTAK	52	12.26	6.39	12.29%
	TOTAL	152	32.00	19.69	12.95%

Thus, it can be seen that the transaction cost total as per cent of loans up to Rs. 25,000 for the five branches range from 12.26% to 14.21% and the average transaction cost works out to 12.95%.

ICICI Bank Study

ICICI Bank has undertaken the study on transaction cost for two operating models :

- Direct handling of loan accounts by bank branch, and
- Microfinance model - purvey of agricultural credit through a microfinance institution.

The bank has considered the following costs :

- Establishment cost of branch as absorbed over the period of time,
- Proportional allocated cost of monitoring offices,
- Direct costs - opening account, disbursement of loans, costs associated with ancillary services like remittance and collection of funds, service (comprising of sales / credit / sanction / collection),
- Promotional costs - interaction with farmer (typically involving stages such as application, sanction, disbursement and weekly or monthly collection),
- Documentation costs - includes, stationery / documentation, stamp duty and other ancillary costs.

The study of transaction cost structure through a bank branch and MFI revealed the following result :

ICICI Bank				
Transaction cost of advances up to Rs. 25,000				
Model	Loan size	Total expenses	Transaction cost	Transaction cost as % of loan size
ICICI Bank	25000	5025	2,156	8.62
ICICI Bank	10000	2010	2,156	21.56
MFI	25000	4375	874	3.50
MFI	10000	1750	874	8.74

The table shows that under the study conducted by ICICI Bank, the expenditure per transaction remains constant irrespective of loan size. Thus, as the loan size goes up, the transaction costs as percentage of loan comes down. For a loan size of Rs. 25,000, the transaction cost comes to 8.62% for the Bank, whereas for loan of Rs. 10,000, it is higher at 21.56%.

College of Agricultural Banking Study

College of Agricultural Banking (CAB), Pune has conducted a study on operating costs of selected MFIs based on their financial statements for the year 2004-05 and 2005-06. The operating costs consist of salary and travel cost in respect of staff and other overheads. The ratio of salary costs to average interest earning assets ranged from 3.7% to 36.2%, with a median value of 19.3% for the year 2004-05 as shown in the table below :

Operating cost ratio of MFIs FY 2004-05				
Name of MFI	Staff salary	Travel	Other O/h	Total operating expenses
Cashpor	23.30	3.20	9.70	36.20
Asmitha	14.80	3.70	6.20	24.70
BISWA	11.60	5.90	5.90	23.40
Grameen Koota	11.30	3.00	7.20	21.50
BASIX	11.10	3.30	5.30	19.70
Share Microfinance	11.80	1.50	6.00	19.30
SKS	10.50	2.40	4.10	17.00
Spandana	4.10	0.50	3.20	7.80
SKDRDP	2.20	1.80	1.60	5.60
Sharmik Bharti	5.50			5.50
Sangamitra	1.20	0.90	1.60	3.70
Average (median)	11.10	2.70	5.60	19.30

Travel expenses form a significant part of service delivery cost of MFIs due to provision of services at the borrowers' doorsteps. The ratio of travel costs to average interest earning assets ranged from 0.5 to 5.9% with a median value of 2.7 %. Such costs vary depending upon the distance covered in reaching the clients, frequency of meetings, mode of financing, individual or group based lending, etc.

An update study was conducted, based on the data for the year 2005-06 and the transaction costs have been computed as under :

Operating cost ratio of MFIs FY 2005-06				
Name of MFI	Staff salary	Travel	Other O/h	Total operating expenses
Cashpor	28.60	4.50	13.00	46.10
Asmitha	17.10	1.80	6.20	25.10
Share Microfinance	13.10	2.30	8.00	23.40
Spandana	13.10	1.60	6.70	21.40
Grameen Koota	8.80	2.10	6.90	17.80
BASIX	7.00	2.20	8.60	17.80
AWARE	12.40	1.00	3.80	17.20
KASF	6.20	1.00	7.00	14.20
SKS	5.50	1.60	6.90	14.00

Operating cost ratio of MFIs FY 2005-06				
Name of MFI	Staff salary	Travel	Other O/h	Total operating expenses
Gram Utthan	4.20	0.30	2.00	6.50
Sharmik Bharti	3.30	0.10	1.10	4.50
SKDRDP	2.00	1.40	0.90	4.30
Sangamitra	1.70	0.80	1.50	4.00
BISWA	1.20	0.90	0.50	2.60
Pushtikar Samiti	0.50	0.00	0.30	0.80
Average (median)	6.20	1.40	6.20	14.20

The update study shows that the operating costs remain high and range widely between 0.8% to 46.1% with a median of 14.2% of earning portfolio, reflecting the diversity of operating models and cost structure.

ANNEXURE V

Suggested Features of SHG – SGSY Convergence Model

Major Features

SHGs to be formed as per the existing practice under the SHG - Bank Linkage Programme by NGOs, banks, Government departments, farmers' clubs, Panchayati Raj Institutions (PRI) and other volunteers.

NABARD to provide grant support for promotion of SHGs to NGOs, RRBs, financial cooperatives, farmers' clubs and PRIs.

Government may provide equity support (revolving fund assistance) matching to the SHG's own "kitty" on half yearly basis through the banks. The proposed equity support (ES) envisages :

- First support after completion of 6 months from the date of opening a savings bank account,
- SHG to save every month,
- ES for a period of three years,
- Amount limited to Rs. 5,000 per SHG,
- Amount will be credited to the savings bank account of SHG.

A self rating norm is to be put in place. Based on the results of ratings - subsequent support will be released at an interval of half year.

The "kitty" of a SHG would constitute of :

- Balance in their savings bank account,
 - Amount lent to members,
 - Interest earned on lendings,
 - Interest earned on savings bank account,
 - Donation, grant assistance, if any, received,
 - Any other receipts.
- Components of the Convergence Model :
- NABARD – promotional support,
 - SHG – kitty,
 - GoI – equity support,
 - Credit from the bank the SHG is linked to.

Benefits from convergence :

- Flexible programme,
 - ❖ poverty alleviation,
 - ❖ expanding outreach,
- Definition of poverty simple,
- Government assistance not motivating factor to form SHG.

Uses of Erstwhile SGSY Funds

SGSY (subsidy) funds may be used for :

A. Creation of Village Centres

A village centre may include work shed-cum-community hall - for example for holding group meetings, training programmes, vaccination camps, exhibitions, weekly haats, housing cluster / federation office, godown / warehouse with locking facilities, anganwadi creche, flood shelter, etc. :

- One village centre for a group of 5 villages,
- Planning and implementation by SHGs.

Benefits of village centres :

- Generate livelihood for SHG members,
- Earn additional income through renting,
- Sense of belongingness to the activities,
- Reduce dependency syndrome.

B. Insurance of SHG Members

- Every member automatically insured against death,
- Extent of liability to the bank,
- Arrangement with Life Insurance Corporation of India,
- Funded from subsidy funds.

ANNEXURE VI

Models of SHG - Federations

MYRADA

MYRADA has experience of more than two decades in the promotion of SHGs. As a withdrawal strategy, it has encouraged the promotion of cluster federations (called Sangha) among SHGs. The maximum number of SHGs in one cluster federation is 20. The structure and functions of these federations are decided by the SHGs. Each group is represented in the Sangha by two members. A unique feature is that even groups not promoted by MYRADA can also become members of the Sangha.

The activities of the Sangha include :

- Regular review of the functioning of member-SHGs,
- Strengthen groups thru' exposure visits, training, audits, etc.,
- Collect and disseminate relevant, useful and interesting information,
- Take up activities of common interest like the conduct of health camps, polio immunization, sanitation, drinking water supply, etc., which cannot be taken up by individual SHGs on their own.

The member-SHGs pay a one-time admission fee of Rs. 101 beside a contribution of Rs. 20 per month to the Sangha to meet its operational expenses. The Sangha meets once a month and has its own rules and regulations, which are made known and accepted by all member-SHGs.

The Sangha is not envisaged as a legally registered body by MYRADA. However, there is no bar on the Sanghas getting themselves registered, if they so desire.

Further, for every 100-120 SHGs, the MYRADA has promoted Community Managed Resource Centres (CMRCs). They have evolved as the off-shoot of the strategy of MYRADA to withdraw from its project areas, after having grounded the SHG movement for several years. Realising that a supportive culture was essential for new institutions to emerge, MYRADA adopted a partial withdrawal strategy, wherein the SHGs were identified as the most appropriate institutions to take the lead in developing a CMRC. Based on their experience in forming Sanghas, MYRADA felt that setting up CMRCs by the SHGs was just another step forward in their journey towards self reliance.

However, in its formative stage, the CMRCs are provided support by MYRADA, both financially and thru' its manpower expertise.

In MYRADA's projects, the CMRC is managed by a Board called the CMRC Management Committee – comprising representatives of SHGs. One resource centre covers a specific area and a limited number of around 125 SHGs who apply to join the centre as members. These SHGs have to reach a certain standard of performance and maturity, which is assessed by the CMRC Board, before a group is inducted as member. The member-SHGs pay an annual fee of Rs. 600⁹ per group to retain membership and are assessed / rated on an annual basis. The CMRC Manager, usually from MYRADA, reports to the CMRC Management Committee. The manager

⁹ Break-down of these fees is as follows : 4 training programmes @ Rs. 75/- each : Rs. 300/-; 12 meetings @ Rs. 10/- each : Rs. 120/- and book-keeping costs (monthly financial statements) 12 months @ Rs. 15/- : Rs. 180/-).

performs an executive function supported by several community resource persons selected by the SHGs.

While the CMRCs have several common features, they also differ in terms of management policy and functions, and there is no standardized framework that all the resource centres have to fit into. However, one common feature which is noteworthy is that none of the RCs act as financial intermediaries to the SHGs for credit linkage. But, for all applications for loans recommended by the CMRC, it charges a service fee of 0.5% of the loan amount sanctioned to the SHG. It is, in practice, mandatory for all member SHGs to route their loan applications to the bank thru' the resource centres. CMRCs are registered as trusts and, as such, have a legal identity.

CMRCs appear to be the off-shoot of MYRADA's thinking that there is a need to evolve suitable development options in the rural areas to facilitate effective utilization of credit. In tune with this, CMRCs have been innovating on the range of services they offer to their members.

DHAN Foundation (Development of Humane Action)

Kalanjiam Community Banking Programme (KCBP)

The KKCBP focuses on women and believes that localised financial institutions owned and controlled by women are an effective strategy to address poverty and gender issues. As part of the field study, a visit was undertaken to the Kanakambari Kalanjia Okkuta at Kanakapura Taluk in Bangalore Rural District.

The following learnings emanated from the discussions with members and other officials of the institution:

Initiation

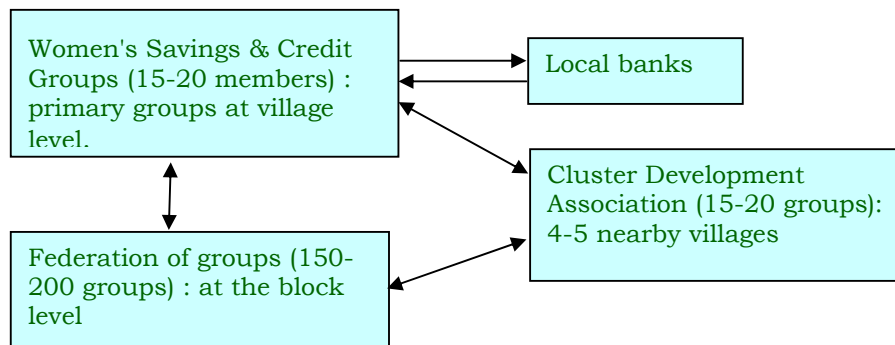
Identification of the geographic area is based on the extent of backwardness, as sourced from secondary data.

A professional is placed in the identified area, who prepares the "Inception Document", which considers the various developmental indicators, provides a sub-sectoral focus to developmental issues besides identifying the potential for group formation and subsequent expansion strategies.

Field personnel called Movement Workers (MWs) are then recruited from among the local populace – usually married and locally settled women are preferred (with high school / PUC level education) – and provided 42 days intensive training. Post-training, these MWs are sent to their respective area (usually Panchayats) for starting group formation work.

Nested Institutions

As part of KCBP groups, clusters and federations are promoted as independent organisations, owned and controlled by members at hamlet, village and block-level. These organisations are promoted as nested institutions with interdependency rather than 'three-tier' type of organisation. Primary groups control both the clusters and federations. The following graphical illustration attempts to capture this organisational framework :



The primary unit of community financial institutions, as practiced under the DHAN model, is the SHG of 15 to 20 poor women and is called the Kalanjiam. They act as a single window at their doorsteps for the savings and credit transactions for their members.

At the Panchayat level, around 15 groups (Kalanjiam) join together to form the Cluster Development Association (CDA). The CDA is normally formed after 12 to 15 months of group formation. The President, Secretary and Treasurer of each member-SHG constitute the General Body of the CDA, from among whom the Executive Committee of 9-11 members is selected. The term of the committee is three years, with one-third of the members retiring by rotation.

The federation (a.k.a. Okkuta), at the block level, is made up of 12–15 clusters and usually comes into existence one year after the CDAs are formed. Each SHG is a member in the Federation, while each SHG member is a shareholder.

Both the CDAs and federations are nested institutions at next higher levels. They reportedly help the SHGs address also other social and development needs of the members such as drinking water supply, health, education, sanitation, access to basic infrastructure, alcoholism, gender issues, etc., thereby enhancing the sustainability of these institutions.

Linkage of the groups to the formal sources of credit takes place only thru' the CDA / federation. The cluster, thru' the federation, helps to create linkages with banks and apex financial institutions to meet the multiple credit needs of members. While all loan requests up to Rs.10,000 per member and / or Rs. 100,000 per SHG is appraised and recommended by the CDA, those exceeding these limits are to be appraised by CDA and recommended by the federation to the banks. All applications have to pass thru' the federation for credit linkage. Further, the CDA / federation also collaborates with other development agencies such as Government departments to demand and access their entitlements, implement civic programmes such as health and education for their members, provide insurance services, etc.

Cost Considerations

The schedule of charges paid at various levels is indicated below :

- a) Between SHG and CDA :
Entrance fee : Rs. 100 per SHG

- Annual fees : Rs. 50 per SHG
- b) Between SHG and federation : (after formation of federation)
- Entrance fee : Rs. 100 per SHG
Annual fees : Rs. 50 per SHG
- c) Between SHG members and federation :
- Equity : Rs. 100 per member
(refundable on member's exit from SHG)
- d) Service charges : Between SHG and cluster
- Depends on age of group / amount of credit linkage
Minimum of Rs. 100 to maximum of Rs. 500/month/group.

For the first three years after formation of a CDA (during which DHAN also gives support), the amount so collected is retained in the CDA. Thereafter, the amount collected in excess of Rs. 1,000 per month will be transferred to the federation.

An overview of the structure, governance, role and functioning of these institutions is indicated in the following table :

Primary Group	Cluster Development Association	Federation
I. Purpose		
<ul style="list-style-type: none"> ➤ To create a separate line of credit for consumption and emergencies. ➤ To redeem the poor from the clutches of loan sharks. ➤ To strengthen and formalise the indigenous savings and credit practices. ➤ To establish a sound mechanism to regulate the household cash flow. ➤ To reduce the cost of transactions and link with mainstream banks. 	<ul style="list-style-type: none"> ➤ To facilitate co-learning and sharing the leadership capacity. ➤ To share the costs and services of local worker and achieve the "scale" advantage. ➤ To achieve financial viability and sustainability. ➤ To ensure quality through self-regulation across member groups. ➤ To build the capacity of leaders and local staff. 	<ul style="list-style-type: none"> ➤ To provide an institutional 'identity' for member groups. ➤ To relate with the mainstream institutions and represent members' interests. ➤ To meet civic needs of members (health & education) and go beyond savings and credit. ➤ To ensure the quality across clusters through self-regulation. ➤ To promote and develop new products.
2. Members and eligibility		
<ul style="list-style-type: none"> ➤ 15-20 individuals - poor women. ➤ Poor women, preferably from a neighbourhood in a slum or village. ➤ Married/widows/des-titute women / divorcees, in some cases, single women identified through participatory processes. 	<ul style="list-style-type: none"> ➤ 15-20 primary groups. ➤ Only primary groups involved in successful savings and credit operations. ➤ Groups should be geographically close in the village. ➤ There should be interaction between the constituent groups for at 	<ul style="list-style-type: none"> ➤ 20-150 primary groups. ➤ Only well performing member groups of clusters in existence for more than six months. ➤ Should participate in various preliminary processes and training programmes organised for evolution of the federation. ➤ Willing to abide by byelaws and pay the equity and membership

Primary Group	Cluster Development Association	Federation
	least three-months before cluster initiation. ➤ Willing to abide by the norms and bylaws evolved by member groups.	fee.
3. Legal status and area of operation		
➤ Informal group at the hamlet or village level. Association of persons legally recognised by the banks.	➤ Informal association of the constituent member groups at cluster of villages or slums.	➤ A legally registered not-for-profit organisation under the Indian Trusts Act (1882) or Societies Registration Act (1860). ➤ Block level or cluster of slums in a city or town.
4. Formation		
➤ Members are self-selected among the poorest identified by DHAN Foundation staff. ➤ First few meetings are facilitated by DHAN Foundation staff where group evolves its own bylaws & operational mechanisms.	➤ Six months after groups are formed. The process of formation is facilitated by DHAN Foundation staff. ➤ Groups interact to evolve the bye-laws and operational systems.	➤ After 18-24 months of group formation. Need for federation is evolved by involving groups. ➤ Groups across clusters interact and organise workshops before initiating federation.
5.1 Governance : general body		
➤ After 18-24 months of group formation. Need for federation is evolved by involving groups. ➤ Groups across clusters interact and organise workshops before initiating federation.	➤ Each primary group is an institutional member and represented by three office bearers. The General Body consists of 45-60 persons @ three members / group representing 15-20 groups.	➤ Each primary group is an institutional member and represented by three office bearers. The General Body consists of 450-600 leaders representing 150-200 groups.
5.2 Governance : executive committee		
➤ Three leaders selected by the group include President, Secretary and Treasurer. Rotation of leaders is practiced once in two years.	➤ Nine members constitute the Executive Committee selected from the General Body. The term of office is for three years.	Nine to eleven members constitute the Board of Directors of the federation. Each Director is selected by the member groups of a geographical area - each slum to represent their interests at the federation for a term of three years. Five members of the Board constitute the executive committee, which include President, Secretary, Vice President, Treasurer and Joint Secretary.

Primary Group	Cluster Development Association	Federation
6. Management – staff		
<ul style="list-style-type: none"> ➤ Movement associate & group accountants are local persons employed for each cluster and their services are shared by groups. Group accountant to write the books of accounts and movement associate to provide auditing, linkage and promotional, developmental support to primary groups. Costs of these staff are paid by groups after one year of promotional phase. 	<ul style="list-style-type: none"> ➤ Each cluster identifies two to three local staff to work for the groups. The Executive Committee reviews the performance of these local staff. Training and capacity building support is provided by DHAN Foundation. Costs are shared by member groups after one year of promotional phase. 	<ul style="list-style-type: none"> ➤ One Chief Executive and one Finance Manager are deputed from DHAN Foundation to the Federation. All costs are met by the federation after three-five years of its promotion. ➤ Memorandum of Understanding is entered between DHAN Foundation and federation. 2-3 support staff to provide specialised services like health, housing, education and insurance based on the age and needs of the federation.
7. Functions / services		
<ul style="list-style-type: none"> ➤ Manage savings (both compulsory and special savings) and credit operations and deal with individual members. ➤ Mobilises loans from commercial banks and CDAs through direct linkage. ➤ Act as a local financial institution for 15-20 members with needed systems. 	<ul style="list-style-type: none"> ➤ To facilitate linkage for primary groups with banks and other development agencies. ➤ Internal auditing and monitoring of systems of primary groups. ➤ Capacity building of members, and leaders for self-management and conflict resolution. ➤ Promotion of new groups - reaching out to left out poor. ➤ Acts as a conduit to channelise loans from federations to groups. 	<ul style="list-style-type: none"> ➤ Meeting the credit gap at groups housing & business needs. ➤ Capacity building of groups and clusters for self-management and problem solving. ➤ Linkages with apex banks, municipality, district administration and development agencies. ➤ Promotion and development of new products e.g. housing, insurance etc. ➤ Promote special programmes to meet civic & developmental needs of members. ➤ Provides interest-free interim loan to SHGs up to 1 month, beyond that treated as Emergency Loan @ 12% p.a. ROI.
8. Sources of funds		
<ul style="list-style-type: none"> ➤ Savings from members ➤ Interest income on loans. ➤ Loans from local banks and clusters at market rates (12% p.a.) 	<ul style="list-style-type: none"> ➤ Entrance fee. ➤ Service costs and interest on loans. ➤ Loans from federations without spread on interest rate. 	<ul style="list-style-type: none"> ➤ Entrance fee and equity. ➤ Service costs and interest on loans. ➤ Loans from apex / development banks for housing & microfinance. ➤ Grants from Government and other philanthropic agencies.

Source : DHAN Foundation

Indira Kranthi Patham (IKP) Project

The Society for Elimination of Rural Poverty (SERP) is implementing Indira Kranthi Patham (IKP) Project in Andhra Pradesh. This is a state-wise, community demand driven rural poverty alleviation project covering all rural poor households in the State. The strategy involves organising poor women into SHGs and then creating higher structures of SHGs. Under this project, the federation model comprises of three tiers : (i) individual SHGs, (ii) Village Organisations (VO), and (iii) Mandal Samakhyas (MS). 6.29 lakh SHGs are organised into 27,748 VOs and 910 MSs. The MS operate at the Mandal level while the VOs operate at the village level. MSs and VOs are registered as mutually aided cooperative societies under MACS Act. One or two representatives from each SHG become members of the VO. Similarly, the membership in MS is through the VOs. The project supports through sub-projects the communities in livelihood investments proposed and implemented by SHGs, VOs, MS, etc. There are three types of sub-projects, viz., (a) income generation; (b) productive physical infrastructure; and (c) social development. The major emphasis is on income generation. The MSs also access funds from external sources and lends it to VOs. Similarly, VOs on-lend to individual SHGs who then on-lend to SHG members. Each tier earns income through interest spread. The MS and VO also collect charges for various services offered by them to their members.

ANNEXURE VII

Review of Different Models of SHG - Federations

In MYRADA, DHAN, etc., the federations are mainly involved in nurturing groups and in lobbying for the rights of members and not in managing finance of SHGs or in providing loans to groups. On the other hand, federations under IKP are involved in providing wide ranging support covering social empowerment, financial resource management and market linkages to its members.

Pre-requisites for Promoting a Federation

The federations, as is evident from the experience of leading SHPIs, are playing an important role in nurturing of groups, in increasing bargaining power of group members and in livelihood promotion. The federations are cost effective and have long term sustainability as these are managed by local communities. A three-tier structure of SHG federation is more common. Under this, the SHG is the primary unit and the building block of the SHG federation. The SHGs, 15-25 in number, are federated at the cluster level. These clusters federate at the Mandal / Block level.

The federation concept should be evolved based on members' needs and priorities. The following aspects need to be considered before evolving federation promotion process :

- Size is a critical factor to be taken into account as a necessary condition for promoting a viable organisation.
- All SHGs should belong to a specific area. A developmental block of a district is the ideal geographical area to promote one viable federation. Scattered SHGs in many blocks may not lead to a functional and viable federation.
- The decision of promoting a federation should not be thrust upon the SHGs. The role of promoting agency should be to sensitize the members and the leaders of SHGs on the need for creating a federation.
- The promoting agency should be professionally well equipped in promoting a federation. It would be helpful to promote a local team who can work on the federation.
- The federation should be promoted among the matured groups.

Role of Federation

The roles that could be performed by the federation are indicated below :

- SHGs are small and informal groups and do not have the ability to negotiate with higher level structures. Networking them into federation would provide them the greater negotiating and bargaining power. This would also be very useful for the promotion of livelihood activities among the SHG members.
- Federations can contribute significantly in building capacities of SHG members in the area of accounting, audit, skill development, etc.
- Federation can play an important role in resolving of conflicts both within and outside the group.
- Federations can help in the promotion of new groups in the area.

- Federations can promote a sense of solidarity among the different members of SHGs.
- They can provide value added services like micro-insurance, and tie-ups with input suppliers and marketing channels.

Activities of Federations

The federations can involve in a variety of activities. The selection of activities would depend on the need of members, maturity level of the federation and the skills of the promoting agency as well as of the federation team. The broad activities of the federation would be :

- To build capacities of groups and clusters in management and problem solving,
- To promote special programmes to meet civic and developmental needs of the members,
- To raise resources from the banks and apex financial institutions and on-lend to the groups,
- To procure and supply agricultural inputs to its members on commission basis,
- To stock consumption goods and sell to its members on a commission basis,
- To aggregate produce of its members and sell it in the market,
- To provide various types of market support to the members involved in micro-enterprises,
- To conduct various types of training programmes, particularly imparting skills to the group members for taking up micro-enterprises.

Viability of Federations

Federations should endeavor to cover their costs on their own after an initial phase of 2 to 3 years. They can earn income or raise resources in a variety of ways :

- Federation can levy entrance fee from its members,
- Federation can charge monthly fee from its members,
- Interest on loans provided to its members,
- Income by way of commission and fee for different types of services provided by the federation to its members,
- Grants received from Government and other philanthropic agencies.

A proper cost coverage system would help federations to meet the cost of its operations. So whenever the federations are lending to SHGs, they should ensure that the interest is fixed in such a way that they are able to meet their cost of operations. Similarly, the federations should provide only those services to users for which they are able to charge commission or fee from them.

Ensuring Quality of Federations

It must be ensured that the quality of the federations is good; otherwise these federations are likely to weaken the SHGs. To ensure this, the following care needs to be taken :

- Federations should be evolved based on the felt need of the SHGs and the group should have freedom to or not to join a federation.
- Building good federations is a complex, time consuming and resource intensive process. The promoters need to have a long term vision in promoting the federations.
- The federations need to be evolved as member owned, member driven institutions so that they can function in a democratic manner, keeping in view the aspirations of their constituents - the SHGs.
- The support process and the operating systems of federations need to be designed in such a way that they do not depend on the promoter perpetually and become self-managed and self-reliant in a reasonable period of time.
- The federations should not normally involve themselves in managing resources of SHGs and in on-lending to groups as it is likely to weaken the self reliance of the groups.

NABARD Support to SHG Federations

NABARD support to the federations can be in the following areas :

- Support to SHPIs for the promotion of new federations. The support can be provided for a period of two to three years and after that the supported organisations should endeavour to cover themselves the cost.
- The existing federations can be supported for :
 - ❖ Improvement in maintenance of accounts and book-keeping,
 - ❖ Capacity building in management and governance,
 - ❖ Promotion of micro-enterprises among their members.
- Strong federations can be supported to act as BFs and BCs to the banks. Such federations can also engage in financial intermediation, micro-insurance, etc. and they can be supported for intensive capacity building for the purpose.

ANNEXURE VIII

Technology Application Models

The technology application model is premised on providing financial services in the rural areas through the BC Model using low cost and simple IT based solutions. There has to be a central system which could be a shared infrastructure providing for economies of scale and consequential cost benefits, and a field system which enables access to the central computer by the business correspondents. The account holders have a Multi-application Smart Card that leverages technology and takes mainstream banking and financial services along with other non-financial services having a social impact, to the customer last mile in a cost effective manner. Biometric-enabled smart cards will be enabled for various financial and non-financial transactions in the field through multiple handheld devices that will be carried by the agent. The backend transaction processing system will cater to the processing and settlement of the transactions captured on the field. While the models which are prevalent in the market today may allow a shared infrastructure, they differ widely in the field systems which enable access through Simputers, and other hand held devices including mobile phones accessing the central system through fixed lines or mobile technology.

The various models have the following essential components :

- A customer with a Multi-application Smart Card which can be a contact card or a contact-less card,
- BC with a simputer / hand held terminal / mobile phone enabling banking services,
- Merchant establishments as points of sale with a terminal,
- A CPU,
- The bank,
- A centralised card management for each of the above systems.

Multi-application Smart Card Features (Financial Innovations and Network Operations (FINO) Ltd.)

- It is advisable to adhere to international best standards comparable to EMV and CEPS standards and should have PKI.
- Biometric enabled smart card that offers the most secure and reliable form of identification by means of world-class fingerprint verification mechanism.
- The Unique Relationship Number (URN) is a number assigned to the customer that helps track customer identify across products, across multiple issuers. It may be called by any other name also.
- Industry standard security featuring using the 3-DES scheme that prevents any unauthorized access to the card and its associated applications.
- The card may contain all the demographic information, health details & net worth details of the customer that provides reliable and ready-to-use information for provision of various products and services.
- The multi-application platform allows loading of various financial and non-financial applications on the same card – banking (savings, loans, RD & FD), financial services (insurance, pension, investments, mutual funds, etc), remittances, community welfare programmes (Rozgar Yojana, public distribution system, etc), health schemes, etc.

- The Card may be enabled for PIN also, so that it can be used on the existing infrastructure like POS machines and ATMs.

The features of each of the illustrative models are as under :

Pigmy Collection Terminal Model (Krishna Bhima Samruddi Local Area Bank) :

- Deploys Pigmy Collection Terminals – which are actually hand-held computers, weighing just about 400 gms,
- Uses them to collect installments on advances, daily deposits for pigmy schemes and other deposits,
- Can store information for up to 1,000 accounts,
- Receipt can be printed and given on the spot, whenever a transaction is made.

Simputers Model (Krishna Bhima Samruddi Local Area Bank) :

- Deploys Simputers (**Simple Computer** or **Simple In-expensive Multi-lingual Computer**) - a product with technology from IISc-Bangalore,
- Low cost portable palmtop - alternative to personal computers,
- Breaks the literacy barrier through natural user interfaces based on sight, touch and audio,
- Has support for multi-lingual text and speech output,
- Has a personalized smart card facility facilitating community-sharing, with no user limitation,
- Customers go to a designated Simputer ‘ATM’,
- Bank employee enters data into the Simputer and accepts / dispenses cash and a receipt is printed out.

Field Hand Held Device Model (FINO Ltd.) :

- Compact and portable device, easy to carry in the field and ideal for a rural / semi-urban scenario,
- A 2-4-line display, 16-key keypad, a thermal printer with 8 hours of battery life,
- Capability to work uninterrupted in a completely offline environment,
- Connectivity agnostic - can function in the field on any means of connectivity that is available in the country - GSM / GPRS, CDMA and the telephone line,
- Device has backward compatibility to support the magstripe cards,
- Embedded fingerprint scanner in the device enabling biometric validation of a customer in the field in offline mode,
- Access to operate the device can be restricted by means of the biometric feature,
- Support for various financial / non-financial transactions in offline mode in the field such as deposit, withdrawal, account transfer, standing instruction, new product request, alerts, etc.

Model Using Mobile Technology (A Little World Pvt. Ltd.- ALW) :

- Central database of various accounts including no-frills zero-balance card accounts at the central computer with the facility to become a pass through for the bank’s host computer,
- Based on new generation Near Field Communications (NFC) mobile phone technology; contact-less radio frequency identification (RFID) smart cards and integrated fingerprint matching,

- Cards have an extensive ID profile, multiple accounts, last known balance and a history of recent transactions. RFID smart cards with high end security (similar to cards embedded in the new United States (US) passports),
- Operators have portable equipment : NFC mobile plus fingerprint unit plus receipt printers,
- All are portable and battery operated. Can last 10 days without electricity,
- Fingerprint matching for all debits to the account,
- Greatly reduced cost per transaction compared to branch based or ATM transactions,
- Transactions online to the banks host (via GPRS or encrypted SMS). Deposit and withdrawals can also be carried out offline, based on risk parameters and counters embedded in cards and devices. Offline transactions are to be sent back to the backend as a batch,
- Customer account is centrally held with the bank (not at the local branch),
- BC keeps working capital in an aggregator account in the banks core banking branch,
- The local operator - customer service point (CSP) deposits some working capital into the BC's account in Bank, and also keeps a reasonable amount of available cash at the outlet,
- Deposit and withdrawal transactions are instantly settled between the customer account and Business Correspondent's account (credit of one account and corresponding debit of the other) - both accounts are in the same system,
- Full traceability and audit trail of the transactions are maintained.

The above models have already been adopted by large private sector and public sector banks, and also a few local banks. The choice of the model has been made by them as per their requirements.

IT-enabled Financial Inclusion Model (ALW)

An IT-enabled financial inclusion model is basically implemented as under :

- Information regarding potential customer is collected by BFs and passed on to the bank in a prescribed format or the BC enrolls the customer account for the bank.
- Banks carry out KYC scrutiny and arrange for opening a Zero Balance Savings Bank Account for the customer, after relevant information is captured.
- The information captured for every customer comprises his photograph, fingerprints and signature (optional). This information is encrypted in the smart card.
- While handing over the card to the customer, the BC activates the card for the customer by fingerprint identification.
- At the time of activation, the balance available in the bank account is recorded on the smart card.
- The operations in the account are simple and easy to follow. A customer can withdraw and deposit money using his smart card at the terminal of the BC. Every time a transaction is made, a printout is provided to the customer. Transactions cannot be undertaken unless a biometric verification of the card holder is done.
- Banking transactions are freed from branch timings and can be done whenever the BC is available with a capture device.

- If a BC does not have requisite money to pay the customer, a printout will be given to him stating that no cash is available at the customer's end. This information will be passed on to the bank through the central processor to facilitate immediate replenishment of cash. Incidentally, this also acts as a check to prevent BCs from denying service to customers.
- The terminal with the BC is operated with a rechargeable battery and is not dependant on steady supply of electricity.
- An added facility that can be enabled is that the customer can use the smart card as a debit card at merchant establishments.
- A CPU integrates village level terminals and identified merchant establishments with the bank.
- The technology seamlessly integrates into core banking solutions of the banks concerned and supports various types of deposits and loan accounts.
- As each hand held model can be used to service 500 to 1000 accounts by a BC, the cost of the device when seen in the context of its servicing capabilities and range is very cost effective.

Transaction Processing and Settlement (ALW and FINO)

It is recommended that an IT-enabled financial inclusion model would have the following features in its transaction processing and settlement :

- Store and forward mechanism used for uploading field transactions originating on handhelds.
- Agent / entity wise detailed transaction reports for all the transactions.
- Integration with core banking system and other third party systems through customized interfaces.
- Support for pushing back end updates to smart card such as interest run, charges, blocking of cards, etc.
- Support for remote parameter configuration such as maximum daily withdrawal amount, maximum cumulative account balance, etc.
- Settlement among multiple banks using the same infrastructure should be supported.

The technology based remote banking models can be used for outreach for the following purposes :

- Microsavings (no-frills pre-paid account),
- Disbursal of Government benefits,
- Microcredit (GCC),
- Farmers credit and benefits,
- Micro-insurance,
- Cash withdrawals,
- Wage disbursements for NREGA,
- Pensions,
- Cashless payments to merchants,
- SHG saving-cum-credit accounts,
- Passbook,
- Equated monthly instalments (EMI),
- Utility payments.

The Committee recommends the transactions be secured appropriately to ensure secrecy and non-repudiation. While the Committee feels that bio-metric cards are appropriate for uniquely identifying individuals, they have noted that certain issues such as the card holders by virtue of their professions which may involve hard work with hands, may not have clear finger prints. It may, therefore, be necessary to have a PIN also associated with the card which while enabling use where biometric fails, may additionally enable the use of the card at the existing infrastructure like ATMs and POS terminals. The BCs may require an overriding power to enable a transaction based on photo identification. Such transactions may have to be captured as incidents requiring addition KYC for such transacting persons.

The RBI Advisory Group in its first meeting has strongly recommended that all the models should follow the best international standards in use for such systems, and they should be such as to permit inter-operability and work on open platforms, and enable a common settlement. The smart cards should adhere to EMV and CEPS standards and should have PKI. The inter-operability was recommended both at the front and the back ends. This would enable the possibility of a card to carry out nation-wide transfer of funds and also creation of a nation-wide information system which has useful policy implications.

Cost Considerations

IT-enabled financial inclusion models can be acquired at relatively low costs. A smart card is estimated to cost around Rs. 100 and a terminal with the BC between Rs. 10,000 to Rs. 20,000 depending upon its features and accessories like printers. The cost of the central processor would depend upon the configuration which in turn is dependant upon the number of accounts, types of accounts, number of transactions, type of reports etc. A processor costing around Rs.35 lakhs (present day pricing) would have the capability of serving multiple districts. As compared to the cost of establishing and operating a physical bank branch in a rural area, the system would be extremely cost effective. It will extend outreach at the doorstep of the farmers, handle even small size transactions, is capable of being operated by persons having local presence and feel, have necessary checks and balances to avoid frauds, protect the interest of depositors and help expand the volume of business for the bank.

ANNEXURE IX

Initiatives on Banking Facilities through the Use of Smart Card Facility

State Bank of India Tiny Initiative

The SBI has launched a project in Nov-Dec 2006 on making available banking facilities to the presently excluded sections of population of Aizwal, Pithoragarh and Medak in the States of Mizoram, Uttarakhand and Andhra Pradesh respectively. SBI has appointed a NGO named Zero Mass as its business correspondent (BC). Zero Mass initially started with coverage of 9 villages and registered 2,400 customers in the first phase. Each village is served through a SBI-Tiny CSP, who is a BC. The CSP is the face of BC in the village, a banking outpost delivering banking services to the customers.

The process of enrollment of beneficiaries for issue of smart cards is as under :

- SBI-Tiny enrolment forms are distributed by the CSPs,
- Prospective customers come to the CSP with filled forms,
- CSP collects the forms, enters the data in a personal computer, captures one photo and two fingerprints of each customer,
- Collected forms are sent to nearest SBI branch for approval,
- Enrolment data are sent to card production centre,
- Cards printed for all customers are approved by SBI branch,
- Printed cards are dispatched to the CSP, and
- CSP hands over card to the customer after verifying the fingerprint and photo.

The registered customers are issued a card with 10 years validity. The cards are built on new generation NFC mobile phone technology and store extensive identity profile including bio-metric finger print data, multiple accounts, last known balance and history of recent transactions.

The BC carries portable equipment - NFC mobile, fingerprint unit and transactions printer - which operate on portable battery with a stand-by time of up to 10 days. Customer identification takes place by matching of photo and fingerprint. The fingerprint unit matches the fingerprint on the card with client fingerprint. Once authenticated, the chip embedded in the card gets charged. When the card with charged chip is brought close to the mobile phone, message templates for deposit, withdrawal and balance enquiry are generated in the mobile. The BC needs to select the relevant option and feed the amount of transaction through the mobile keypads and send the message to the backend server. The server authenticates the message, processes the transaction and sends an update back to the mobile, which in turn writes back to the card. When the card is brought close to the printer, a transaction report is printed in triplicate. The BC keeps working capital in an aggregator account in a SBI core banking branch and carries cash physically for making payments to customers.

The available services include savings product (SBI-Tiny no-frills pre-paid account), microcredit, micro-insurance, cash withdrawal and can be used for routing Government payments.

SBI is targeting to cover 100,000 villages and issue one crore SBI Tiny smart cards linked to their existing network of semi-urban and rural branches within a period of 12 to 18 months.

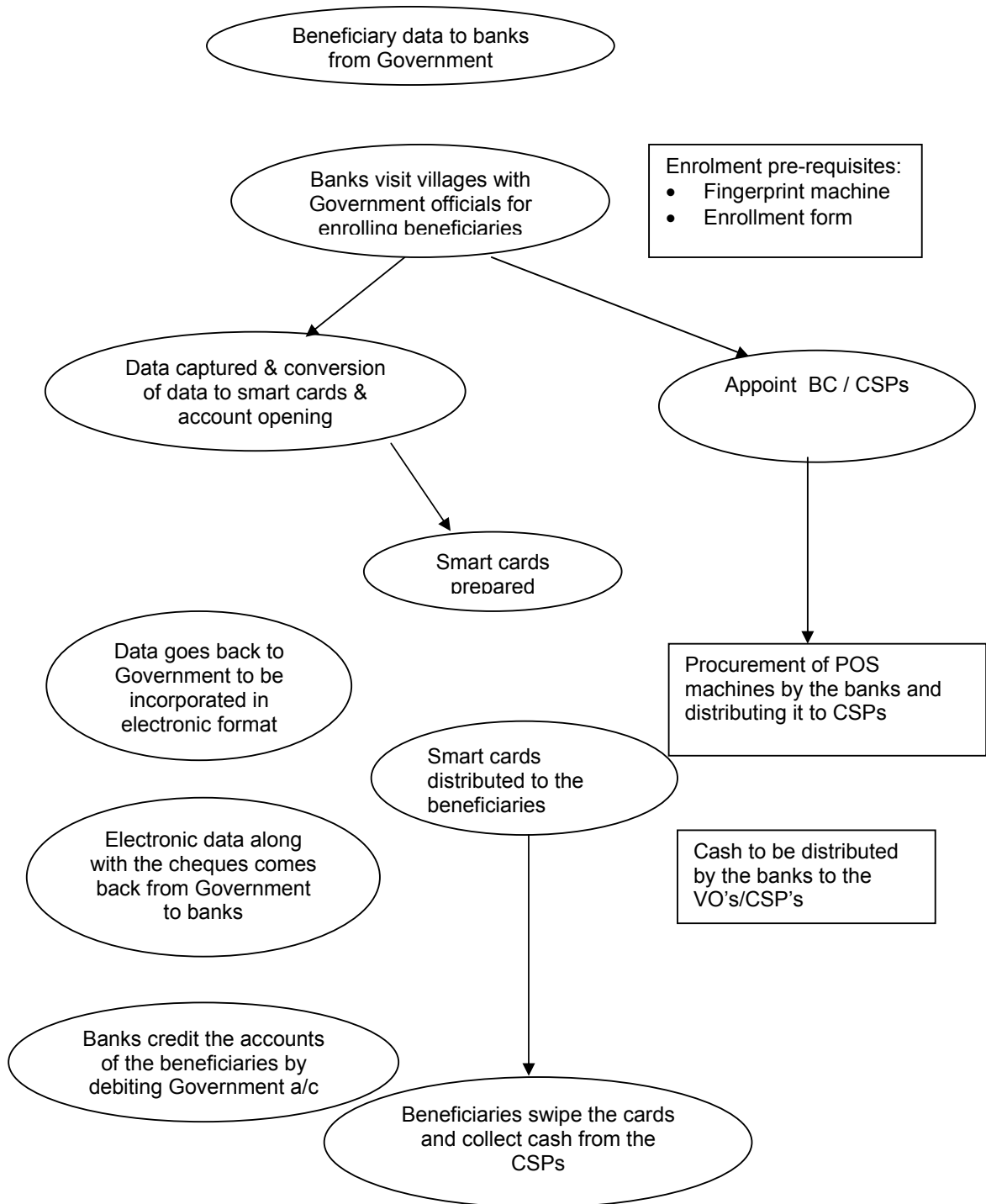
Government of Andhra Pradesh (GoAP) Project on Social Security Payments through Smart Cards

The GoAP has successfully launched a pilot project on routing social security payments to widows, handicapped, old and eligible weavers through the use of smart cards and BCs. The pilot involves six banks - SBI, Union Bank of India, UTI Bank, State Bank of Hyderabad, Andhra Bank and Andhra Pradesh Grameen Vikas Bank. The first phase of the pilot was successfully launched on April 30, 2007, wherein three banks - SBI, Union Bank of India and UTI Bank disbursed social security payments to 127 beneficiaries in 3 villages through intermediaries. Payments were made to more than 2000 beneficiaries of these villages in this stage during the first week of May 2007. By the first week of June, 2007 nearly 10,000 beneficiaries would be covered. With the inclusion of Andhra Pradesh Rural Employment Guarantee Scheme, the fully scaled up project is expected to cover 5 million beneficiaries. In the discussions, the Government has mentioned that over a period of time, almost all the Government payments can be routed through this mechanism so that the benefits reach the people at their doorstep.

The technology adopted for the project is similar to the one adopted by SBI-Tiny project discussed above. The cards store six fingerprints as against two fingerprints in the case of SBI Tiny project. The transaction model is also similar except that the GoAP issues the beneficiary data to the banks, who enroll them for issue of smart cards. The GoAP also transfers the money to banks for making payments. The CSPs have been selected from the existing VOs. A diagrammatic illustration of the transaction model is enclosed below.

The project is the first experiment in routing Government payments through use of intermediaries and smart card technology. Its successful launch reflects the potential of the model in routing other Government payments through the use of such technology. The decision of the Andhra Pradesh Government to meet a substantial portion of the card and device cost has helped nurture the pilot project.

GoAP Project Structure



Key Learnings from the Two Initiatives

The poor people are prompt in accepting technology that delivers value and convenience to them. In both the projects, the clients have accepted the technology.

The banks can improve their coverage comprehensively by adopting technology and intermediaries. The banks participating in the pilot projects have extended operations to areas which were hitherto uncovered.

While the initial cost of acquiring small ticket financial inclusion accounts is seen to be high in view of their low returns, the cost of transaction is very low when compared to the traditional banking methods. Thus, this model would gain acceptance when more products of the banks are routed through them.

Banks would need to deploy substantial resources for enrollment process and making of smart cards during the initial stage. There would also be need for training of beneficiaries and CSPs. Banks would need support from the Financial Inclusion Fund and the Financial Inclusion Technology Fund to part fund the exercise. BC capacity building is the biggest challenge in financial inclusion as the potential of technology in this area is already proven.

By engaging Government machinery and routing Government payment, the banks can generate additional resources to fund the exercise. Also, it would add to the credibility of the process. Further, micro-insurance remains a potential money spinner. Banks can also think of shifting several products like crop loans, small vehicle loans, artisan loans etc., on to the smart cards.

There are presently several technology providers active in this domain, however, only two are widely accepted, each backed by one major bank in the private and public sector. Major banking players are aligning with either of the two. More technology providers are likely to come forward as the technology adoption picks up.

There would be a need for a minimum basic level of uniformity in capturing, storage and transmittal of biometric data. The RBI has constituted a group to look into standards for storage of raw image. The draft report of the group is being discussed and recommendations emerging within the group are to align the standards to the ISO-IEC (International Organisation for Standardisation - International Electrotechnical Committee) international standards. This aspect would be necessary to ensure that key bio-metric data can be used for other applications.

The responsibility for customer service and control of operations have to be exercised by banks, who are supposed to conduct thorough due diligence before appointing intermediaries. However, during the initial stage, inter agency coordination among banks, technology providers, business intermediaries and Government agencies would require extensive formalization and periodic reviews.

In a few cases, the banks had not worked out the detailed accounting procedure to be adopted for employing BCs especially while routing Government payments. Similarly, arrangement of cash for the BCs needs to be planned in advance.

Supply of spares, consumables and maintenance services would have to be meticulously planned by technology providers, BCs and banks. Here too, with time and greater volumes independent suppliers may come up.

In the case of the GoAP project, a few ineligible beneficiaries were identified. Thus, technology ensures that only the intended beneficiaries receive the Government benefits.

The use of intermediaries by banks may be opposed by unions and banks may have to enter into a dialogue with their respective unions for generating acceptance to the idea.

ANNEXURE X

International Experiences on Financial Inclusion Country Wise Inputs

Developed Countries

United Kingdom

In UK, financial exclusion is concentrated in certain geographical areas. According to HM Treasury estimate, the country has a relatively high number of households and individuals of 12% without bank accounts. As part of the 2004 spending review, the UK Government has set out its commitment to tackle financial exclusion and undertook specific proposals in three key priority areas such as access to banking services, access to affordable credit and access to money advice. A “Financial Inclusion Fund” of £ 120 million has been set up over three years to support initiatives to tackle financial exclusion, the progress of which will be monitored by a Financial Inclusion Task Force.

The Government has recognized that the most financially excluded would benefit from face to face money advice and has set up a fund of £ 45 million for the same. This will be administered by the Department of Trade and Industry. The Government is seeking to work with potential providers to develop proposals for delivering a significant increase in the capacity of free face-to-face money advice targeted in areas of high financial exclusion. The face-to-face money advice is mainly provided by citizens advice bureaus, community development groups etc.

The major contribution from the banking sector in UK is the introduction of a BBA with no frills and 24 hours basic banking services. POCA was also introduced with huge financial contribution from the banks for those who cannot have the BBA. The concept of Savings Gateway has been piloted aiming to encourage banking habits by means of Government funded match of all money saved, up to a certain limit. This offers those on low-income employment £ 1 from the state for every £ 1 they invest, up to a maximum of £ 25 per month. The credit unions were offered more functional flexibility for providing affordable credit simultaneously tightening the legal provision ensuring safety for investors. A platform for collaboration between local Governments and financial institutions has also been set up, in order to ensure that, everyone has access to financial services. Banks have also been taking active participation by engaging even managers in delivering money advice. Many banks like Barclays and HSBC have supported access to money advice through contributions to the Money Advice Trust. Banks have placed their staff in community development organisations also and encouraged staff volunteering programmes in social development. Few banks like Royal Bank of Scotland Group have set up their own fund for promoting financial inclusion. In addition the Community Finance Learning Initiatives were also introduced with a view to promoting basic financial literacy among housing association tenants.

The banking sector in UK has played a proactive role in promoting financial inclusion by making partnerships with projects and organisations fighting financial exclusion like children fund projects, housing association projects, financial education trusts and also with charity organisations like the Passage. The Banks were cautious enough to promote also awareness, provide information and impart training to their employees.

United States of America

In USA, between 9.5 and 20% of households lack a bank account. Around 22% of low income families (over 8.4 million families earning under US\$ 25,000 per year) do not have either a current or savings account.

In USA, the CRA has been enacted to contribute to financial inclusion and it prohibits discrimination by banks against families with low and moderate incomes. All the licensed and chartered banks have been mandated to fulfill social obligations by enabling access to banking services to excluded sections. The Act imposes an affirmative and continuing responsibility on banks to cater to the banking facilities and credit needs of the communities in which they are chartered to do business.

The Home Mortgage Disclosure Act requires banks to disclose details of people and groups to whom they are currently offering services. The banks are also made to adhere to a greater transparency in account maintenance through a written disclosure of the features of the account prior to opening of the account itself.

The Departments of Banking in some States like New York made it an obligation for the banking sector to provide access to banking facilities to all citizens with a view to extend low cost banking services to customers. It is mandatory that banks shall offer BBAs in the case of depositors and Basic Share Draft Accounts (BSA) in the case of borrowers with minimum costs.

Numerous studies conducted by the Federal Reserve Bank and Harvard University demonstrated that CRA lending is a win-win proposition and profitable to banks. In addition, the legislation had the effect of changing other aspects of commercial behaviour. For example, banks often give money to community development funds in order to ensure positive scoring when lending is disclosed under the above legislative instruments.

Canada

During 2003, legislation entitled “Access to Basic Banking Services Regulations” was introduced in the country to ensure that all Canadians could obtain personal bank accounts without difficulty. Financial institutions are required to open personal bank accounts as well as cash most Government cheques at no charge (even to non-customers) for any individual that meets basic requirements. The Federal Government also introduced legislation requiring banks to offer a standard low cost bank account with a basket of services. Memoranda of Understanding were signed between the Federal Government and eight financial institutions to ensure that all Canadians have access to affordable banking services.

Germany

In Germany, during 1995, the banking industry endorsed a joint recommendation entitled “Current Accounts for Everyone”, undertaking to provide current accounts on demand. There have been a further two reports (1996 and 2000) on the effects of this voluntary undertaking. The results have so far been positive and so the Federal Government has chosen not to legislate in this area at this time.

France

The 1984 Banking Act made access to a bank account a legal right in France. Any person refused a bank account can apply to the Bank of France, which will nominate an institution to provide the bank account. In addition, in 1992, French banks signed a

charter committing them to opening a bank account at an affordable cost with related payment facilities.

Developing / Less Developed Countries

Africa

In 2004, the UNDP and United Nations Capital Development Fund (UNCDF) joined efforts to build a regional programme - BISFA - for financial inclusion in Africa. BIFSA's goal is to contribute to the achievement of the Millennium Development Goals (MDGs) particularly the specific goal of cutting poverty in half by 2015, by increasing sustainable access to financial services in Sub-Saharan Africa for poor and low income people and for micro and small enterprises. The programme follows a three-step process of financial sector development approach which includes (i) conducting a financial sector assessment in each country, (ii) working through an open, participatory process with multiple stakeholders to develop policy, strategy and a national action plan for building an inclusive financial sector and (iii) assisting policy makers and a broad range of financial institutions, development agencies, the private sector, and other financial market participants to implement this action plan.

In South Africa, "MZANSI" a low cost national bank account was launched in October 2004 extending banking services to low income market segments and especially to that segment for which the banking services were elusive till recently. MZANSI is a card based, saving account with easy availability at accessible outlets like merchant point-of-sale and post offices. This initiative has put full service banking within at most 15 kilometers of all citizens. Even an ATM is within 10 kilometer of their homes. By the end of August 2005, more than 1.5 million MZANSI accounts were opened, in which majority were of such persons who had never availed banking facilities before.

Bolivia

Bolivia has financial deepening of around 60%, based on financial sector assets of US\$ 4.84 bn, in 2004. The overall credit portfolio was around US\$ 3.3 million. The country has a network of 503 branches of regulated and unregulated entities serving a population of six million, which means one branch for every 12,000 population.

The institutions include 5 Private Financial Funds (PFF) that specialize in lending to small and micro-enterprises, 2 specialized microfinance banks, 14 NGOs, and several unregulated credit unions. The commercial banks in Bolivia do not offer microfinance. Regulated intermediaries that specialize in microfinance represent 12% of the total loan portfolio of the financial system, and 38% of the total clients. Unregulated intermediaries represent only 3% of the total loan portfolio, but 30% of the clients. Commercial banks with 70% of the portfolio reach out to only 20% of the total client base.

The microfinance industry in Bolivia became a success on its own before the public sector took note of it. The regulated MFIs in Bolivia have grown while the unregulated have been starved of lending funds. Regulated MFIs grew out of very high quality non-profit lenders (NGOs) which were professionally managed, and had high profitability. Special non-bank licenses for finance companies were issued in 1992. PRODEM, the largest NGO became a licensed commercial bank in 1992. The microfinance portfolio grew by around 20 times in the 1990s. Starting 1999, the industry grew fast, and over-indebtedness of the previous years coincided with an

overall macro-economic crisis. Lately, however, the sector has seen consolidation and growth and volume of operations, and loan sizes are all on stable growth paths.

The Bolivian bank supervisor has created a structure for microfinance with virtually no interference from political leaders. There has been lesser success in improving the legal environment that affects microfinance negatively. A level playing field, however, has been created for commercial banks and other entities doing microfinance from a compliance and regulatory perspective.

The Bolivian example shows a patient market development strategy implemented by a highly capable supervisory agency. The supervisor allowed experimentation, collected and shared timely market information, and engaged the sector in ongoing dialogue while elaborating its technocratic regulatory approach to microfinance. High standards were set for the FFP niche, and gradually MFIs were brought into the regulated sector. Subsidies and promotional schemes were avoided and the range of financial services offered was broadened by the regulator.

Mexico

About 6% of the rural population and 15-20% of the urban population have access to financial services. Of the nearly 11 million poor households, 4 million had accounts with people's savings and credit institutions and 3 million with BANSEFI branches.

There are around 500 institutions which provide savings and credit services to low and medium income families. The commercial banks which dominate the finance sector with 42% of the total assets of the financial system, do not lend to the poor. Banca de Desarrollo (development bank), Nacional Financiera, and BANSEFI own 11% of the assets of the financial system. Pension funds have 12%, investment societies 11%, and NBFCs have 4% of the total assets. The BANSEFI network has promoted supporting entities for the sector : a second tier central bank, an IT platform, L@Red de la Gente and a pension fund. It is planned to transfer the ownership of these to the sector over time.

The sector has grown by 20% annually, since the new laws were approved. The Mexican example shows consolidation and institutional transformation at several levels. The apex bank, Banrural was converted into Financiera Rural in 2003, which has tailored credit products and sector specific programs. In 2001 a development bank, BANSEFI was established as the State vehicle to promote savings, develop "central" entities and to support the sector. A savings based, demand driven, sustainable microfinance program for the poor, PATMIR was introduced. This involved expert foreign consultants for the technical assistance.

In 2001, the Government designed a policy in order to transform the extant semi-informal financial sector into an opportunity for deepening the financial system. This policy includes two pillars that will have to converge in time, creating a legal and regulatory framework in line with best practices, and strengthening institutional capacity of the sector. The Ley de Ahorro Credito Popular is a functional law : it regulates savings and credit activities and not institutions. Only two legal forms can be licensed to operate under the law, the Savings and Credit Cooperative Organisations (SACCOs) and Popular Finance Partnerships (PFPs).

In Mexico, financial services are being provided in a modern, reliable and cost-efficient manner, and the capacity for doing so has been built centrally and top down. The Mexican rural financial system now has a regulatory framework according to the best international standards, however, supervision is delegated to the autonomous

supervisory committees of the federations of SACCOs and PFPs. Savings has much more precedence over credit, and a host of other financial services were also introduced. The successful program PATMIR reaching out to less developed areas and lower income groups by creating long run access infrastructure has many lessons to offer for financial services in poorer areas.

Indonesia

As of 2001, the financial deepening in Indonesia was 101%. In the same year, the number of MFIs in Indonesia was around 53,000, seven times the number of branches of commercial banks. There are 44 million depositors, 30 million borrowers, and US\$ 141 billion in assets.

There are several types of microfinance institutions in Indonesia such as commercial banks including Bank Rakyat Indonesia (BRI) owned by Government with its large “Unit Desa” network operating at sub-district level, the mostly privately owned rural BPRs (Bank Perkreditan Rakyat or People’s Credit Banks), the BKDs (Badan Kredit Desa or Village Credit Organisations owned by Village Governments), the LDKPs (Lembaga Dana dan Kredit Pedesaan or Rural Fund and Credit Institution which are non-bank MFIs mostly owned by Provincial Governments), and credit cooperatives. The regulated entities, BRI-Units and BPRs, cover the upper end of the micro-enterprise market. The average loan size of Unit Desa is around US\$ 75. The BKDs serve lower income clients with average loan amounts of about US\$ 53. There are some credit cooperatives, sponsored by the Government, which are in poor financial health. The commercial banks have not made a significant dent in the microfinance market in Indonesia, even though some of them are replicating the BRI Unit Desa system; loan sizes are relatively high at around US\$983.

The rural financial institutions are largely owned by Government at village and provincial levels. In 1983, in the wake of new financial reforms undertaken by the Indonesian Government, the BRI transformed its Unit Desa network from loss-making channeling agents for the Government subsidised credit program for rice cultivation (BIMAS) into commercial microfinance intermediaries. This turnaround into profitable entities is at the heart of the Indonesian model. It was done at an incredible pace, and in a sustainable manner. Especially remarkable was also that the Units increased their savings at a rapid rate during the turnaround period. Besides these entities, there has been focus on the commercial bank - BPR linkage, with the former lending to the latter for onlending to small and micro-enterprises. There has also been a conscious strategy of converting LDKPs and BKDs into BPRs.

Deregulation of the banking sector started in 1983 and included removal of ceiling on credit expansion and allowing banks to set their interest rates. The revival of Unit Desas was done with discontinuing the subsidized rice credit program, introducing performance based incentives and retraining of staff at all levels. The diverse service providers in Indonesia largely had weak governance and oversized systems. Since the 1990s, Indonesia has been addressing these by harmonizing standards (using the BPR model), and delegating supervision while building mainline supervision capacity in the BI. The role of the BI itself was redefined in 1999 with the BI Act.

Much of the success in Indonesia has been due to the BRI system. The system is a classical case of turnaround from Government owned subsidized credit system to a microfinance system based on viable commercial principles with steady consolidation. The Unit Desas have achieved profitability with high outreach to the

poor. Financial liberalization and a flexible approach to prudential governance of microfinance operations have been the planks for transforming the sector in Indonesia.

Bangladesh

Bangladeshi MFIs lead both in regional and global outreach. The number of customers served per institution is above or close to 4 million customers each for the three largest MFIs, Grameen Bank, ASA (Association for Social Development) and BRAC (Bangladesh Rural Advancement Committee).

Amongst the institutions involved in microfinance the Grameen Bank is the only formal financial institution in Bangladesh, all others are registered as NGOs. BRAC is a finance plus NGO with added social programs. Proshika matches members' savings and credit with marketing and technical assistance. The Credit and Development Forum (CDF) estimates that around 1,500 MFIs are operating in Bangladesh. The majority of MFIs are small and the bulk of the access to microfinance services is provided by the four large MFIs. The Microfinance Research and Reference Unit, (MRRU) of the Bangladesh Bank had data for December 2005, for 469 NGO-MFIs, with over 7,700 branches, covering around 14 million customers. Palli Karma Sahayak Foundation (PKSF), is an apex microcredit funding agency established in 1990. PKSF provides wholesale funds to its partner organisations for onlending to the poor and also engages in capacity building initiatives of these institutions.

Grameen Bank, which was started as an experiment in 1976 was converted into a Government regulated bank in 1984 by an ordinance of the Government. NGOs grew in number and scale and by the 1990s BRAC, ASA, Proshika and Grameen Bank dominated the development discourse in the country. By the mid-1990s, the minimalist, microcredit-only approach gave way to greater focus on a wider range of financial services. From vanilla credit products, they moved towards product differentiation both by end use and target segments. The institutions and their structures remained the same, and operations kept expanding at a very fast pace. For example Grameen Bank and ASA have added around 1.3 million customers each in 2005. The system is largely driven by savings and soft funds, and the use of commercial funds has increased to around 20% of the total loan portfolio of Bangladeshi MFIs as recently as 2005.

The sector has grown on its own, and in the absence of regulation. After the phenomenal success of the Grameen Bank, it was brought under Government regulation. NGO-MFIs are not regulated, supervised or monitored by any single authority in Bangladesh. At best, they are under the system of offsite supervision by the authorities that provide them registration as NGOs. The different stakeholders involved in the sector are increasingly focused on the need to develop a supportive regulatory framework. A high power national Steering Committee under the leadership of the Governor of the Bangladesh Bank is responsible for formulating a uniform guideline and the legal framework of a regulatory body. This Committee has submitted a draft law to the Government, which should lead to the creation of a formal financial system in near future.

The peer-lending system, compulsory savings, administrative structure, and business approach are suited to the culture of rural Bangladesh. Successful replications must seek to modify Grameen's systems and practices to suit their own socio-political environments, and not merely transplant the exact institutional structure and policies

of Grameen Bank. The high efficiency levels of MFIs (cost of US\$ 9 per borrower) are also very context and business model specific, and need not necessarily be a target in dissimilar situations.

Annexure XI

Facilitating Financial Inclusion: Initiatives by Reserve Bank of India

In the Annual Policy Statement of the Reserve Bank for 2005-06 it was observed as under:

- RBI will implement policies to encourage banks which provide extensive services while disincentivising those which are not responsive to the banking needs of the community, including the underprivileged.
- The nature, scope and cost of services will be monitored to assess whether there is any denial, implicit or explicit, of basic banking services to the common person.
- Banks are urged to review their existing practices to align them with the objective of financial inclusion.

In keeping with these objectives, the Reserve Bank has formulated its broad approach to financial inclusion as indicated below.

- **Approach to Financial Inclusion**

The Reserve Bank's broad approach to Financial Inclusion is as under:

- Aim at 'connecting' people with the banking system and not just credit dispensation.
- Aim at giving people access to the payments system.
- Use multiple channels such as civil service organizations, NGOs, post offices, farmers' clubs, panchayats, MFIs, etc. as Business Facilitators to expand the outreach of banks.
- Adopt a decentralized approach, which is state and region specific and has close involvement and cooperation between the respective State Governments and banks.
- Make use of ICT using bio-metric smart cards and mobile hand held electronic devices for receipts and disbursement of cash by agents of banks, such as business facilitators/correspondents.
- Portray financial inclusion as a viable business model and opportunity.
- Aim at continuous evaluation, sharing of experiences, feedback and improvement.

In consonance with the above broad approach, the Reserve Bank has undertaken a number of measures for attracting the financially excluded population into the structured financial system.

No-Frills Accounts and General Purpose Credit Cards

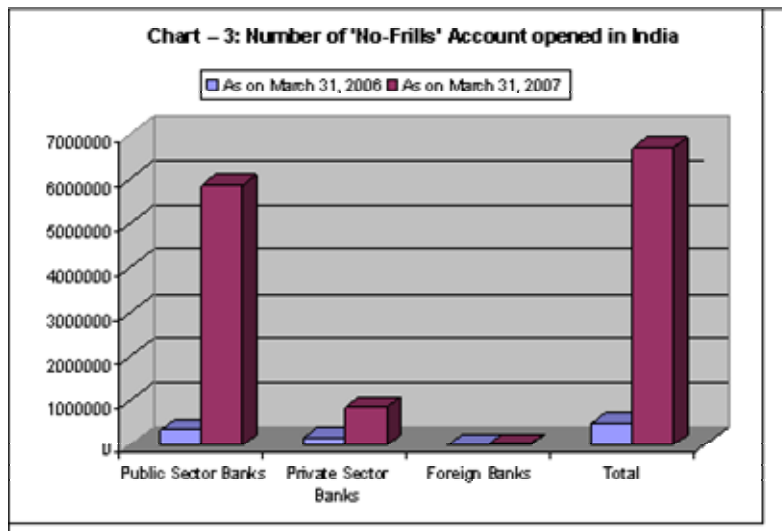
- (i) In November 2005, banks were advised to make available a basic banking 'no-frills' account with low or nil minimum balances as well as charges to expand the outreach of such accounts to vast sections of the population.
- (ii) Banks are required to make available all printed material used by retail customers in the concerned regional language.
- (iii) In order to ensure that persons belonging to low income group, both in urban and rural areas do not encounter difficulties in opening bank

accounts, the know your customer (KYC) procedure for opening accounts has been simplified for those accounts with balances not exceeding Rs 50,000/- and credits thereto not exceeding Rs.1,00,000/- in a year. The simplified procedure allows introduction by a customer on whom full KYC drill has been followed

(iv) Banks have been asked to consider introduction of a General Purpose Credit Card (GCC) facility up to Rs. 25,000/- at their rural and semi-urban branches. 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 or purpose. Interest rate on the facility is completely deregulated. Fifty per cent of the GCC loans can be treated as part of the banks' priority sector lending.

- **Adoption of Districts for 100% Financial Inclusion**

- (i) A decentralized strategy has been adopted for ensuring financial inclusion. The State Level Bankers Committee (SLBC) identifies one district for 100 % financial inclusion. Surveys are then conducted using various databases such as electoral rolls, public distribution system, or other household data, to identify households without bank account. Responsibility is given to the banks in the area for ensuring that all those who wanted to have a bank account are provided with one by allocating the villages among the different banks. Bank staff or their agents who are usually local NGOs or village volunteers contact the households at their doorstep.
- (ii) Recognizing the need for providing social security to vulnerable groups, in some cases banks have provided, in association with insurance companies, innovative insurance policies at affordable cost, covering life disability and health cover. SHGs and MFIs are also being used extensively for financial inclusion on the credit side.
- (iii) So far, SLBCs have reported having achieved 100 per cent financial inclusion in the Union Territory of Puducherry, Himachal Pradesh and in some districts of Haryana, Karnataka, Kerala, Punjab and Rajasthan. Reserve Bank advised its Regional Directors to undertake an evaluation of the progress made in these districts by an independent external agency to draw lessons for further action in this regard. The outcome of the efforts made is reflected in the increase of 6 million new 'no frills' bank accounts opened between March 2006 and 2007. The progress made in opening of 'No-Frills Accounts' is given in the chart hereunder.



- (iv) In certain less developed States, such as in North Eastern Region, Bihar, Chhatisgarh and Uttarakhand, Working Groups headed by the representatives of the Reserve Bank have made specific recommendations for financial inclusion, strengthening financial institutions and improving currency and payments systems. The concerned regional offices of the Reserve Bank are monitoring the implementation of these recommendations.

- **Use of Intermediaries as Agents in Microfinance**

- In January 2006, the Reserve Bank permitted banks to utilise the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions (other than Non-Banking Financial Companies) and other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models. 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.
- Banks are also entering into agreements with Indian Postal Authorities for using the enormous network of post offices as business correspondents, thereby increasing their outreach and leveraging on the postman's intimate knowledge of the local population and trust reposed in him.

- **Use of ICT Solutions for Enhancing Outreach of Banks**

- The Reserve Bank has been encouraging the use of ICT solutions by banks for enhancing their outreach with the help of their Business Correspondents (BCs). The BCs carry hand-held devices, which are essentially smart card readers. The information captured is transmitted to a central server where the accounts are maintained. These devices are used for making payments to rural customers and receiving cash from them at their doorsteps.
- Mobile phones have also been developed to serve as card readers. Account holders are issued smart cards, which have their photographs and finger impressions. Certain banks have been using this technology in

Andhra Pradesh, Karnataka and Maharashtra. Pilot studies have also been carried out in Mizoram and Uttarakhand.

- **Financial Literacy and Credit Counselling**

- (i) Recognising that lack of awareness is a major factor for financial exclusion Reserve Bank is taking a number of measures for increasing financial literacy and credit counseling. A multilingual website in 13 Indian languages on all matters concerning banking and the common person has been launched by the Reserve Bank on 18 June 2007. Comic type books introducing banking to schoolchildren have already been put on the website. Similar books will be prepared for different target groups such as rural households, urban poor, defence personnel, women and small entrepreneurs. Financial literacy programs are being launched in each State with the active involvement of the State government and the SLBC.
- (ii) Each SLBC convenor has been asked to set up a credit-counselling centre in one district as a pilot and extend it to all other districts in due course.
- (iii) A Centre for Financial Education & Excellence is proposed to be set up in RBI's College of Agricultural Banking at Pune

continued

Success Stories

Pragathi Gramin Bank, Bellary, Karnataka (Sponsor: Canara Bank)

- 628 villages covered with 100 percent financial inclusion
- 8,26,173 families of SHG members financially included
- Two out of seven districts served by the bank have 100 percent inclusion
- The RRB plans to cover one million families by March 2008

Indian Bank in Asia's Largest Slum, Dharavi, Mumbai - Application of Core Banking Solution

Dharavi, Asia's largest slum is inhabited by lakhs of migrant labour from Tamilnadu who do not have bank accounts. After the KYC norms were rationalized to enable opening of 'No Frills' Accounts, Indian Bank has opened a Core Banking branch in Dharavi Slums. The KYC of migrant labour can also be done at the home district in Tamilnadu. As the bank has branches at the places from where the migrant labour has come, remittances to and fro have become very easy as they are just transfers between the accounts of the bank. Thus, the urban financially excluded have been given banking access and now it is found that many of the account holders who were otherwise spending on consumption have started saving. Thus, the core banking solution in banks can be a powerful remittance tool for the migrant labour.

Pilot Project in Andhra Pradesh

Andhra Pradesh Government has embarked on a pilot project with six banks, viz., SBI, SBH, Andhra Bank, Union Bank, UTI Bank and AP Grameena Vikas Bank, to make payments of Social Security Pensions and AP Rural Employment Guarantee Scheme benefits to 50,000 beneficiaries in six Mandals of Warangal district through the use of business correspondents and contact less smart card/mobile technology. The state proposes to scale up the project to cover the nearly five million beneficiaries of the entire state in due course. The state has signed an MOU with banks and Institute for Development and Research in Banking Technology (IDRBT) for the purpose. The state is also meeting the major portion of cost of the smart cards and also of the other devices used in the

Union Bank of India- Village Knowledge Centres

Keeping in view the urgent requirement to educate the rural inhabitants and farmers in particular, for updating them with the latest technological developments, a pioneering effort has been initiated by Union Bank of India by establishing Village Knowledge Centres (VKCs) at strategic rural locations to ensure following aspects

- To impart information and guidance on latest Agricultural skills and developments
- To offer updates on climatic conditions, current market prices of agricultural produce
- Implementation of programmes such as formation of Self Help Groups (SHGs) and Farmers clubs, etc.
- To make command area villages as "100% banked villages".
- To guide farmers about our Bank's various loan products/schemes and guidance for availing loan from bank.

So far bank has established 198 VKCs all over the country and these centres have been provided with basic infrastructure like Internet connection and updated libraries with periodicals on Agriculture and allied activities and rural marketing subjects.

Bank of India's 'Abhay' – Credit Counselling Centre

The Credit Counseling services were started under the aegis of the Trust "ABHAY " which was launched at the hands of His Excellency President of India Dr. A.P.J. Abdul Kalam at New Delhi on 25th August, 2006. The first center was inaugurated at Mumbai by Dr. Y.V.Reddy, Governor, Reserve Bank of India on 7th September,2006 which was followed by Centres at Wardha in Nagpur and Chennai.

The following are the main objectives of the Trust.

- Advising on gaining access to structured financial system including banking
- Creating awareness among the public about financial management
- Counseling people who are struggling to meet the repayment obligations and helping debt resolution
- Helping in rehabilitation of borrowers in distress