An overview of the financial inclusion policies in India

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Abstract

Evidence of the importance of financial inclusion for economic growth and development are now well established and documented but little is known about the role institutions and policies can play and how institutional frameworks can support inclusive financial development. This paper is a case study on India, aiming to present the recent initiatives taken by the main institutional stakeholders to reach full financial inclusion in the country.

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1 Introduction

Literature has long established the positive impact of an efficient and extended financial sector on economic growth and development. Building a financially inclusive system that promotes economic growth is therefore both a priority and a challenge for developing countries. All stakeholders have a role to play and the construction of an efficient framework serving all segments of the population, especially the lower-income section, is key. However, there is still a lot to understand about the link between public institutions and the effect of their policies and initiatives on financial inclusion, particularly in the context of developing countries. It is still rather unclear how institutional frameworks can support inclusive financial development and what institutions and policies are the most relevant for financial inclusion.

In India there is a consensus on the importance of financial inclusion for the country. The Indian authorities, no matter their political orientation, have been putting an emphasis on financial inclusion for several years, with an acceleration of their efforts over the last 5 years. Many initiatives and schemes have been conceived and implemented by different public stakeholders. This paper aims to facilitate the understanding of the past and actual institutional initiatives towards financial inclusion in India.

The paper is organized as follows: Section 1 presents the state of the literature and evidence on the importance of financial inclusion and describes its status in India. Then the following sections detail the past and recent initiatives of the Indian institutional framework, including the Government of India (GoI), the Reserve Bank of India (RBI) and the National Bank for Agriculture and Rural Development (NABARD).

2 Financial inclusion, key for growth and development at the country and individual levels

2.1 A growing literature supporting financial inclusion to support growth and development

According to Demirg-Kunt et al. (2014) discussing the Global Findex Database 2014, 62% of adults worldwide have an account at a bank or another type of financial institution or with a mobile money provider, up from 51% in 2011. Between 2011 and 2014, 700 million adults became account holders while the number of those without an account dropped by 20% to 2 billion. Account penetration differs enormously between high-income and developing countries in the aggregate: 89% of adults in high-income countries, but only 24% in low-income countries, report that they have an account at a formal financial institution.

For long the positive relationship between financial development and growth has been established. The accumulating body of evidence supports the assessment that developing inclusive financial systems is an important component for economic and development progress. Financial markets are supposed to make the match between savers and users and to allocate capital toward the highest productive usage (e.g., Mankiw and Ball 2011).

In their study Campos and Dercon (2014) sum up the latest findings on the relationship between finance and growth, so far considered as causal and unidirectional from finance to growth: (i) The long-run effect of finance on growth is positive and dominates the short-term effect that tends to be negative (Kaminsky and Schmukler, 2003; and Loayza and Ranciere, 2006); (ii) The relationship may be non-linear: beyond a certain threshold (calculated to be above 100% of GDP) finance is associated with negative growth (Berkes et al. 2012); (iii) Distribution is important: household credit seems to have little growth payoffs, while private
sector credit has large growth payoffs (Beck, 2013); (iv) Financial development reduces income inequality and exerts a disproportionally positive impact on the bottom quintile; (v) Different financial liberalisation policies have contrasting effects on income inequality. Delis et al. (2013) report that capital stringency and supervisory power regulation lower inequality, while market discipline and activity restrictions may exacerbate it.

A growing literature shows that financial inclusion can have a significant positive effect for individuals. Several studies have demonstrated that the lack of financial access can lead to poverty traps and inequality (Banerjee and Newman, 1993; Galor an Zeira, 1993; Aghion and Bolton, 1997; Beck Demirg -Kunt and Levine, 2007). Similarly an expanding literature highlights the positive consequences of access to saving instruments: on savings increase (Aportela, 1999; Ashraf et al. 2010a), on productive investment (Dupas and Robinson, 2009), on consumption (Dupas and Robinson, 2009; Ashraf et al., 2010b), and female empowerment (Ashraf et al., 2010b). Researchers are also looking at the beneficial effects of access to credit and insurance products (Karlan and Morduch, 2010; Banerjee et al., 2010; Roodman, 2012).

A growing number of randomized evaluations suggests that financial services do have a positive impact on a variety of microeconomic indicators, including self-employment business activities, household consumption, and well-being (Bauchet et al. 2011), the effects encountered depending on the financial service considered. For instance regarding credit products, two main patterns stand out: small businesses do benefit from access to credit while the linkage to broader welfare is less clear (Banerjee, Duflo, Glennerster, and Kinnan 2010 and 2013). As per insurance products, recent randomized evaluations in India and Ghana of weather-based index insurance showed strong positive impact on farmers because the assurance of better returns encouraged farmers to shift from subsistence to riskier cash crops (Cole, et al. 2013; Karlan, Osei-Akoto, Osei, and Udry 2014).

2.2 The Indian context: between impressive progress and persistent challenges

Growth forecast in Asia and Pacific outperform the rest of the world for 2015 (+5.6%) and 2016 (+5.5%) according to the IMF Regional Economic Outlook. Performance among the countries will be mixed, with China’s economy slowing down (+6.8% in 2015, +6.3% expected in 2016), Japan picking up (+1% in 2015, +1.2% expected in 2016) while India's growth is expected to rise to 7.2% in 2014/2015 and +7.5% in 2015/2016, driven by stronger investment following improvements to the business climate, and making it one of the fastest growing economies in the world. The Indian economy is strengthening, supported by pro-active policy actions, and lower global oil prices according the latest IMF assessment of the country. The IMF also highlights that bolstering financial sector health and further financial inclusion would support growth going forward. They encourage the authorities to continue to move toward direct cash transfer payments, helped by India’s unique identification system (Aadhaar), to help better targeting of subsidies (which can have large leakages) toward the vulnerable.

According to the World Bank, high growth during 2004/05 and 2009/10 enabled accelerated poverty reduction. Compared with the previous decade, the rate of poverty reduction doubled, with the share of the population living below the poverty line falling from 37.2% in 2004/05 to 29.8% in 2009/10. The poverty headcount rate, measured using the national poverty line, declined indeed by 1.5 percentage points per year in 2004/05 to 2009/10, double the rate of the preceding decade. However poverty reduction rate has been lower than what could have been expected given the Indian economic performances and went along with a rise in inequality, with the Gini index climbing from 0.27 in rural and 0.35 in urban India in 2004/05 to about 0.28 and 0.37, respectively, in 2009/10.
To fight these disparities, the government put an emphasis on achieving more inclusive growth, as stated as key objective in the Eleventh Five Year Plan (2007/08 to 2011/12). The Twelfth Five Year Plan documents describe the objective “of India moving forward in a way that would ensure a broad-based improvement in living standards of all sections of the people through a growth process which is faster than in the past, more inclusive and also more environmentally sustainable”.

Over the next 15 years, India’s economy will have to generate jobs for the one hundred million young Indians who will enter the job market during this period, constituting for India the largest, and among the youngest, workforces in the world. Important reforms and policies have been initiated and conducted; however, the country will need to keep implementing reforms, including policies to stimulate financial inclusion especially in the agriculture and MSME sectors, two key components of the Indian economy.

Financial inclusion has expended in India over the past years, as indicated by the indicators collected for the World Bank Global Findex database. Between both implementations of this survey in 2011 and 2014, 53% of adults are reported to have a bank account, which is a sharp increase from 35% in 2011. The banking penetration has drastically increased in rural areas between 2011 and 2014 with 50% in 2014 against 33% in 2011.

However these good numbers have to be balanced with some less positive facts identified also in this database. There is still a long way to go in the attempt to target financial inclusion efforts towards the poorest section of the Indian population. Among the 40% poorest population, 56% of the adults (15+) are unbanked, compared to 41% of the adults belonging to the “richest 60%”. Usage of bank accounts is also an issue that deserves more attention. 43% of account holders did not make any deposits or withdrawals in their bank accounts in the past year. 67% of account holders reported of not making a single deposit in any typical month.

### Table 1: Pradhan Mantri Jan - Dhan Yojana (Accounts opened as on 01.07.2015, Figures in millions)

<table>
<thead>
<tr>
<th></th>
<th>Number Of Accounts</th>
<th>No Of Rupay Debit Cards</th>
<th>% of Zero Balance Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural</td>
<td>Urban</td>
<td>Total</td>
</tr>
<tr>
<td>Public Sector Bank</td>
<td>70.7</td>
<td>58.7</td>
<td>129.4</td>
</tr>
<tr>
<td>Rural Regional Bank</td>
<td>25.1</td>
<td>4.4</td>
<td>29.5</td>
</tr>
<tr>
<td>Private Banks</td>
<td>4</td>
<td>2.8</td>
<td>6.8</td>
</tr>
<tr>
<td>Total</td>
<td>99.8</td>
<td>65.8</td>
<td>165.7</td>
</tr>
</tbody>
</table>

Source: GoI PMJDY Progress Report

Other dimensions of financial inclusion remain to be improved. Informal borrowing is still an important issue: 13% adults (% age 15+) borrowed from money lenders; and 32% from friends.

3. Agriculture plays a vital role in the Indian economy with more than 70% of the rural households depending on agriculture as their principal means of livelihood. India is the second largest agricultural land with 157.35 million hectares. The GDP of agriculture and allied sectors in India was recorded at US$156.1 billion in 2014 with a growth of 3.6%.

4. The micro, small and medium enterprises constitute another pillar of the Indian growth. According to the report from the Indian Ministry of MSMEs “MSMEs at a glance” Indian SME sector contributes to 45% of the industrial output, 40% of the country’s total exports, employs over 60 million people, creates 1.3 million jobs every year and produces more than 8,000 quality products for the domestic and international markets. There are around 30 million MSME in India and the sector will welcome 12 million workers in the next 3 years and the sector to grow at 8% per year.
and relatives. More women have access to financial services today however the gender gap is increasing: it was of 18 points in 2011 (44% male and 26% female with bank accounts), while there is a 19 points difference in 2014 (62% male and 43% female with bank accounts). Cash transactions are still the rule in India, despite the development of credit/debit cards, mobile phone banking, ATMs, etc. Only 20% of adults (% age 15+) reported to have debit cards, and 4% credit cards, and only 11% adults used their debit cards in the previous year.

All types of bills or fees are mostly paid in cash. For example, among the 22% of adults who have to pay school fees, 99% paid in cash (6% reported of using a bank account as well). Among the 19% of adults (15+) who received wages in the past year, 86% received wages in cash. Moreover Payment System (IMPS) has been launched, but only 2% adults have mobile accounts (58% of adults in Kenya have mobile accounts). Among the bank account holders, only 6% had ever made any kind of transaction from an account at a financial institution using a mobile phone. There is a huge scope for digitalization of financial services and bank transfers, including government subsidies, wages, etc.

Taking into account the status of financial inclusion indicators in India and the need for a strong political will for improvement, the Indian institutions have conceived successive plans to tackle the bottlenecks.

3 The Evolution of the Financial Inclusion Movement in India

leading to the presentation of the global plans in force since 2010: Swabimaan program (2010-2013) and Pradhan Mantri Jan-Dhan Yojana (PMJDY)

Credit and saving tools had long existed in India, created and run by the poor for the poor, like the chit fund mechanism, before financial inclusion became a political priority. Early initiatives were launched in the mid-70s by NABARD with the creation of Regional Rural Banks. Nowadays the main actors of the financial inclusion policy are the Government of India (GoI) and the Reserve Bank of India (RBI). The initial efforts were focused on making cheap credit products available to poor households for asset creation, with the formal banking system as a close partner and channel of distribution.

In the 1990s the microfinance revolution took place in the country and helped open the credit market to remote areas and show that it was possible for microfinance institutions (MFI) to serve the poor and be profitable. Early-on it was recognized by the Indian authorities that financial inclusion alone will not be enough for development, to fight against poverty and vulnerability and to support economic security and visible livelihoods. Several committees were called and reports issued to define financial inclusion and the goals for India in this matter, and both evolved over time.

In 2008 the Rangarajan Committee stated that “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”. In 2014 the RBI Governor Raghuram Rajan declared that financial inclusion was about (i) “the broadening of financial services to those who do not have access to financial services, (ii) the deepening of financial services for people who have minimal financial services and (iii) greater financial literacy and consumer protection”. Following the evolution of the financial inclusion concept and understanding, the Indian strategy has similarly evolved. From 2010 to 2013 the Government of India had initiated the Swabimaan program. In 2013 a new scheme, called Pradhan Mantri Jan-Dhan Yojana has been launched by the new administration in place.
The differences in the two approaches are summarized in the table 2 below.

<table>
<thead>
<tr>
<th>Earlier approach: Swabimaan program</th>
<th>New approach: PMJDY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Villages with population greater than 2000 covered, thus limited geographical coverage</td>
<td>Focus on household</td>
</tr>
<tr>
<td>Only rural</td>
<td>Both rural and urban</td>
</tr>
<tr>
<td>Bank Mitr (Business Correspondent) was visiting on fixed days only</td>
<td>Fixed point Bank Mitr (BC) in each SA (3 to 4 villages on average) to visit other villages in the SSA on fixed days SA comprising of 1000-1500 households</td>
</tr>
<tr>
<td>Offline accounts opening—technology lock-in with the vendor</td>
<td>Only online accounts in CBS of bank</td>
</tr>
<tr>
<td>Focus on account opening and large number of accounts remained dormant</td>
<td>Account opening to be integrated with DBT, credit, insurance and pension</td>
</tr>
<tr>
<td>Inter-operability of accounts was not there</td>
<td>Inter-operability through RuPay Debit card, AEPS, etc.</td>
</tr>
<tr>
<td>No use of mobile banking</td>
<td>Mobile Wallet and USSD-based mobile banking to be utilized</td>
</tr>
<tr>
<td>Cumbersome KYC formalities</td>
<td>Simplified KYC/e-KYC in lace as per RBI guidelines</td>
</tr>
<tr>
<td>No guidelines on the remuneration of the Bank Mitr (BCs). Banks went generally with Corporate BCs who used to be least expensive to them</td>
<td>Minimum remuneration of the Bank Mitr (BC) to be Rs 5000 (fixed + variable) with structured monitoring mechanism at centre, state and district levels.</td>
</tr>
<tr>
<td>A recent RBI survey finds that 47% of Bank Mitr are untraceable</td>
<td>Viability and sustainability of Bank Mitr (BC) is identified as a critical component</td>
</tr>
<tr>
<td>Monitoring left to banks</td>
<td>Financial inclusion campaign in Mission Mode</td>
</tr>
<tr>
<td>Financial literacy has no focus</td>
<td>The rural branches of banks to have a dedicated Financial Literacy Cell</td>
</tr>
<tr>
<td>No active involvement of states/districts</td>
<td>State-level and district level monitoring committees to be set-up</td>
</tr>
<tr>
<td>No brand visibility of the program and Bank Mitr (BC)</td>
<td>Brand visibility for the program and Bank Mitr (BC) proposed</td>
</tr>
<tr>
<td>Providing credit facilities was not encouraged</td>
<td>OD limit after satisfactory operations/credit history of 6 months</td>
</tr>
<tr>
<td>No grievance redressal mechanism</td>
<td>Grievance redressal at SLBC level in respective state</td>
</tr>
</tbody>
</table>

Source: Nair T. and A. Tankha (2012)
The PMJDY aims to ensure access to various financial services like basic savings account, need-based credit, remittances facility, insurance and pension to the lower-income groups. According to the GoI, the results obtained by the first phase of the Swabhimaan plan were disappointing: while banks had achieved their targets, it had limited reach and impact. It is estimated that 75 million households were still excluded from formal financial services, 60 million in rural areas and 15 million in urban zones. The financial inclusion policy of the new PMJDY program has then been conceived and is based on six objectives that are scheduled to be achieved in two phases:

Phase I (15 August 2014 - 14 August 2015)

1. Universal access to banking facilities (within 5km distance of each village);
2. Providing basic banking accounts for saving and remittance and RuPay Debit Card with in-built accident insurance cover of Rs. 100,000;
3. Financial Literacy Program

Phase II (15 August 2015 - 15 August 2018)

4. Overdraft facility of up to Rs. 5000 after 6 months of satisfactory performance of saving/credit history (a credit guarantee fund would be created for coverage of defaults in overdraft accounts.);
5. Micro-insurance;
6. Unorganized sector pension schemes like Swalamban.

To achieve these targets the Indian authorities rely on previous initiatives towards financial inclusion and new ones conceived under this new scheme. All stakeholders are involved in the process of improving and deepening financial inclusion.

4 The Government of India, instigator of the financial inclusion efforts

The Government of India has been the central actor in the financial inclusion initiative, which has remained at the center of the public priorities despite the change of government and of political majority.

4.1 The Government of India has designed several schemes with a financial inclusion objective at heart.

This is the case of instance with the national pension scheme (NPS): in 2004, the GoI decided to move from a defined-benefit pension system to a defined-contribution pension system. Apart from offering a range of investment options to employees, the scheme allows individuals to make decisions about where their pension fund is invested, permits limited withdrawal prior to retirement and reduces the total pension liabilities of the Government of India. Initially, NPS was introduced for the new government recruits (except armed forces). With effect from May 1st, 2009, NPS has been provided for all citizens of the country including the unorganized sector workers on voluntary basis. The pension scheme is administered on behalf of the government by the Pension Fund Regulatory and Development Authority (PFRDA).

Other schemes launched by the GoI include:
(i) Swavalamban scheme launched in October 2010 and closed in May 2015 (replaced by Atal pension Yojana scheme on June 1st 2015) was the unorganized sector pension scheme, thought
to address the old age income protection need of unorganized/informal sector workers which represent 85% of the working population;

(ii) **Swarnajayanti Gram Swarojgar Yojana (SGSY)**, launched in December 1999 was a centrally sponsored scheme that followed the mechanism of forming SHGs of rural poor households, providing capacity building training and linking groups to bank. SGSY was formed from a merger and restructuring of the Integrated Rural Development Program (IRDP) and allied skills generation programs, namely Training for Rural Youth for Self Employment (TRYSEM), Development of Women and Children in Rural Areas (DWRCA), Supply of Toolkits in Rural Areas (SITRA), Ganga Kalyan Yojana (GKY) and Million Wells Scheme (MWS);

(iii) **National Rural Livelihood Mission (NRLM)** launched in June 2010 by the Ministry of Rural Development expanding nationwide the poverty alleviation program Indira Kranti Patham to take over from the SGSY scheme. With the support of international institutions like the World Bank, this scheme combines handholding, training and capacity building and credit linkage. The handholding component includes external (dedicated professional institutions at the State, district and sub-district levels) and internal support in the form of SHG federations at the village level, and block level and later on at district level.

(iv) **Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS)**, enacted as an Act in the Parliament in September 2005, aims to enhance the livelihood of the rural people by guaranteeing at least one hundred days of wage employment in a financial year to a rural household whose adult members volunteer to do unskilled manual work. The primary objective of the Scheme is to augment the wage employment and the auxiliary objective is to strengthen natural resource management through works that address causes of chronic poverty like drought, deforestation, soil erosion, etc., and thus encourage sustainable development.

(v) **Aadhaar Unique Identification Authority in India (UIDAI)**, is an initiative to provide an individual identification number to every citizen of India which will serve as a proof of identity and address, anywhere in India and enable people to have access to services such as banking, mobile phone connections and other government and non-government schemes. The UIDAI was created through a notification issued by the Government in January 2009. Phase II of the program has commenced with an allocation of more than 30 billion rupees in July 2010 for enrolling 100 million residents through multiple registrars. Biometrics would prevent multiple enrolments by the same individual (a problem for many existing service programs), while providing nearly foolproof identity authentication.

(vi) **Credit Guarantee Fund Trust for Micro and Small Enterprises**, created in 2000 (initially called Credit Guarantee Fund Scheme for Small Industries (CGFSI) and renamed in 2006) aims to guarantee the availability of bank credit to MSMEs by reassuring the lender that, in the event of a MSE unit (which availed collateral free credit facilities) failing to discharge its liabilities to the lender, the Guarantee Trust would make good the loss incurred by the lender up to 85% of the credit facility. The scheme is open to new as well as existing Micro and Small Enterprises, with a maximum credit cap of Rs. 10 million.

(vii) The **Jan-Suraksha scheme** was announced in February 2015 by Finance Minister and launched in May by Prime Minister. It involves the creation of a universal social security system for all Indians, especially the poor and under-privileged through three key parts: **Pradhan Mantri Suraksha Bima Yojana** (accident insurance), **Prahan Mantri Jeevaan Jyoti Bima Yojana** (life insurance) and **Atal pension Yojana** (pension scheme).
4.2 The GoI has also put technology at the center of its initiatives, believing in its role to foster financial inclusion.

For instance the PMJDY scheme includes a **USSD-based mobile banking service**, launched in August 2014, through the gateway provided through National Payments Commission of India (NPCI) to banks, following a recommendation from the Technical Committee on mobile banking.

Similarly, **Immediate Payment Service (IMPS)** was launched by the National Payments Corporation of India (NPCI) in November 2010. The NPCI has facilitated inter-bank mobile banking payment enabling real time transfer of funds between bank accounts and providing a centralized inter-bank settlement service for mobile banking transactions.

**Micro ATMs** have been rolled out over the country, with the first ATM installed in India in 1987. Several initiatives were led to enhance the ATM technology. A recent innovation is the **National Financial Swift (NFS)** operated by NPCI that facilitates routing of ATM transactions through interconnectivity between the bank’s switches, allowing the customers to use any ATM of a connected bank.

**RuPay Cards**, launched by NPCI in March 2012, is a new card payment scheme at a lower cost and allowing for more flexibility, customizable to the client needs and including protection of consumer’s information principles and options for electronic products. It aims to be an efficient domestic alternative to international product facilitators such as MasterCard and Visa and to enable Indian banks and financial institutions to offer electronic payments.

The **Aadhaar-enabled payment systems (AEPS)** is now a banking product allowing online inter-operable financial inclusion transactions at the micro ATM or kiosk banking through Business Correspondents. The transactions include withdrawals and deposits along with funds transfers between Aadhaar-enabled card holders.

The **Aadhaar Payments Bridge System (APBS)** enables the transfer of payments from government to Aadhaar-enabled accounts of beneficiaries at banks and post offices.

**Direct Benefit Transfers (DBT) program**: In January 2013, the GoI launched the DBT program to transform service delivery in India by transferring government benefits and subsidies directly into the hands of residents through the biometric based identification system (Aadhaar), speeding up payments, removing leakages and intermediaries, and enhancing financial inclusion. This program is run through the AEP and APB systems.

The DBT initiative includes 35 schemes and among them the **PaHaL (Pratyasksh Hanstantrit Labh) program**: a Direct Benefit Transfer for liquefied petroleum gas (LPG) program. This scheme stimulates bank account opening by linking Aadhaar numbers to an active bank account, a suggested condition to benefit from this government program.

The DBTL scheme was launched earlier on June 1st 2013 and covered 291 districts. It required the consumer to mandatorily have an Aadhaar number for availing LPG Subsidy. The government has reviewed the scheme and after examining the difficulties faced by the consumer and modified the scheme prior to launch, giving the possibility for the consumer to directly receive subsidy in his bank account without the use of an Aadhaar number. The modified scheme was re-launched in 54 districts on November 15th 2014 in the 1st Phase and in the rest of the country on January 1st 2015.
4.3 An emphasis was put on key sectors like Agriculture and MSME.

Recognizing the importance of the agriculture Sector, the Government has issued a series of reforms and schemes to stimulate the sector. These initiatives include (i) enhanced institutional credit to farmers; (ii) promotion of scientific warehousing infrastructure; (iii) improved access to irrigation through Pradhan Mantri Krishi Sichayee Yojana; (iv) provision of Price Stabilization Fund to mitigate price volatility in agricultural products; etc. They are supposed to generate a continuing growth in the sector over the coming years, thanks to increased investments in infrastructure, reduced transaction costs, fiscal incentives, etc. Given the importance of the sector for the Indian economy, it is crucial to monitor initiatives, their outcomes and the trends in the agricultural sector.

To support and reinforce this dynamic the Government has put in places several schemes, for instance:

(i) **Prime Minister Employment Generation Program (PMEGP)**, a “credit linked Scheme to facilitate participation of financial institutions for higher credit flow to micro sector”; 

(ii) **ASPIRE**, “to promote Innovation & Rural Entrepreneurship through rural livelihood incubator and technology business incubator”;

(iii) **Scheme of Fund for Regeneration of Traditional Industries (SFURTI)** to “make traditional Industries more productive and competitive by organizing the traditional Industries and artisans into clusters”;

(iv) **Performance & Credit Rating Scheme**, “to create an eco-system of MSEs for easier and cheaper access to credit for the rated enterprises”;

(v) **Assistance to Training Institution**, “to promote entrepreneurship and skill development through capital grant for creation and strengthening of infrastructure and program support for conducting entrepreneurship development and skill development programs”; etc.

These initiatives and the MSMEs sector as a whole will be a key tool to attain more inclusive growth and poverty reduction, hence it has to be carefully studied.

5 An enabling environment for financial inclusion thanks to RBI

Being proactive and supportive vis-a-vis the financial inclusion movement, RBI has launched several policies allowing banks and finance institutions to come up with innovative products.

5.1 RBI is facilitating the financial inclusion efforts putting in place favorable regulations.

The **Priority Sector Lending initiative** was established by RBI to ensure that those sectors of the economy, which may not get timely and adequate credit in the absence of this special dispensation, have access to credit tools from Indian banks. The list of sectors has been revised in April 2015 and includes agriculture, micro and small enterprises, education, housing, export credit, etc. New sectors like renewable energy and social infrastructure have been added too and the new norms require banks to ensure that 8% of their loans go to small and marginal farmers.

RBI has relaxed a number of norms and requested documents to open a bank account by people who plan to keep a balance lower than Rs 50,000 and whose total credit in all the accounts
together will not exceed Rs 100,000 in a year (simplified KYC form, June 2014). Similarly a simplified bank saving account opening has been put in place and RBI has permitted banks to open branches without taking authorization in tier 3 to 6 cities, towns and villages. RBI also asked banks to provide all the material related to opening accounts, disclosures, etc. in the regional languages. Banks were permitted in 2006 to partner with other rural organizations, like NGOs, SHGs, MFIs, etc., while RBI reinforced self-regulation in the microfinance sector, appointing Sa-dhan and MFIN as self-regulation organizations.

**No-Frills Accounts/Basic Savings Bank Deposit Accounts:** In 2005, RBI introduced the concept of No-Frills Account, now renamed Basic Savings Bank Deposit Accounts (BSBDAs), targeting the poor and allowing banks to open accounts with zero balance or very minimum balance requirements. In 2012, RBI has issued new guidelines for the BSDBA including the following characteristics:

- No requirement of any minimum balance;
- Services available include deposit and withdrawal of cash at bank branch as well as free ATMs-cum-Debit Card; receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques drawn by Central/State Government agencies and departments;
- No limit on the number of deposits that can be made in a month, maximum of four withdrawals in a month, including ATM withdrawals;
- No charge levied for non-operation/activation of in-operative BSBD Account;
- BSDBDA guidelines applicable to all scheduled commercial banks in India including foreign banks having branches in India.

Banks have also been advised to provide overdraft (OD) facility in saving account and also Small Overdrafts in No-frills accounts. The **Kisan Credit Cards scheme** allows banks to issue smart cards to farmers for providing timely credit support from single window banking system for their farming needs. It was introduced by the GoI, RBI and NABARD in 1998. In 2005 RBI issued guidelines to banks to provide General Purpose Credit Card (GCC) which facilitate credit up to Rs.25000/- without any collateral requirement for rural and semi-urban people based on assessment of household cash flows.

**Business Facilitator/Business Correspondents.** The Business Facilitator (BF)/Business Correspondent (BC) was another innovation, initially created by banks and then supported by RBI policy. The BC/BF model is a model based on information and communication technology (ICT): intermediaries or BC/BFs are technologically empowered by the banks to provide the last mile delivery of financial products and services. RBI issued the first guidelines for business correspondents for banks in January 2006. In November 2009, RBI requested banks to prepare a road-map to provide banking services in every village with a population of more than 2000 inhabitants, by March 2013. It was specified that these services could be delivered through a traditional brick-and-mortar branch but also using various forms of branchless banking, including Business Correspondents. The list of eligible entities to act as BCs has been regularly extended by RBI and today the sector presents an abundance of models and types of BC structures and agencies involving different roles and functions.

**Technology-based innovations.** Thanks to an enabling environment, banks and other financial institutions have been in constant search and development of economically viable channels.

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5. Part of the renaming of this account is due to the fact that the “no-frill” nomenclature has become a stigma.
and methods to reach the last mile user of financial services. With many of this model failing or experiencing difficulties to be viable, the role of technology has been brought forward as a key factor for economically viable financial inclusion. After ATMs being installed from 1987, internet banking appeared in India in 1997.

Over the past 10 years electronic payments received a big push with the development of a retail electronic payment system comprising of Electronic Clearing Service (ECS), National Electronic Fund Transfer (NEFT), Pre-paid Payment System (PPI), and Point of Sales (POS) Terminals/online transactions. Today banks are tying up partnerships with telecommunication companies to provide banking and financial services through mobile, which has, with other digital banking tools, an important potential in terms of financial inclusion, especially in remote areas and isolated and poor population.

**Financial literacy approach.** RBI is also in harmony with the GoI when it comes to put forward the importance of financial literacy for the success of all other financial inclusion initiatives. For instance in 2012 RBI issued guidelines for the Financial Literacy Centers initiative, based on the recommendations from the Working Group to Examine the Procedures and Processes of Agricultural Loans, appointed by the Reserve Bank. In its report (April 2007) the Group recommended that banks should actively consider opening counselling centers, either individually or with pooled resources, for credit and technological counselling. The broad objective of the FLCCs is to provide free financial literacy/education and credit counseling, with a special focus on the rural areas, but should not, however, act as investment advice centers.

The specific objectives of the FLCCs are:

- To educate the people in rural and urban areas with regard to various financial products and services available from the formal financial sector;
- To make the people aware of the advantages of being connected with the formal financial sector;
- To provide face-to-face financial counselling services, including education on responsible borrowing and offering debt counselling to individuals who are indebted to formal and/or informal financial sectors;
- To formulate debt restructuring plans for borrowers in distress and recommend the same to formal financial institutions, including cooperatives, for consideration;
- To take up any such activity that promotes financial literacy, awareness of the banking products, financial planning and amelioration of debt-related distress of an individual;
- To take up any other activity that facilitates the above.
5.2 Recently RBI has announced new initiatives to impulse a new impetus to the financial inclusion movement

Among RBI latest initiatives, on November 27th 2014 were issued the final guidelines for companies seeking to set up payments banks and small finance banks in a bid to expand banking services to more people and small businesses.

The objective of setting up small finance banks (SFB) is to extend financial inclusion by provision of savings vehicles and supply of credit to small business units, small and marginal farmers, micro and small industries and other unorganized sector entities, through high technology-low cost operations.

Some of the relevant guidelines for SFB regarding financial inclusion are listed below:

- It aims to provide a whole suite of basic banking products—deposits, credit, but in a limited area of operation.

- Loans and advances of up to Rs. 2,500,000 primarily to micro enterprises, should constitute at least 50% of the loan portfolio; this could make more sense for MFIs who want to grow faster because the ticket sizes can get bigger.

- For the first three years, 25% of branches should be in unbanked rural areas.
The small finance banks will be required to extend 75% of its adjusted net bank credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by RBI.

Payments banks would be able to accept demand deposits with a cap of 100,000 rupees per individual customer. They can issue ATM/debit cards but not credit cards. They can also provide payments and remittance services through various channels and become business correspondent of another bank. Moreover, they can distribute non-risk sharing simple financial products like mutual fund units and insurance products, etc. Their objective is to increase financial inclusion by providing small savings accounts, payment/remittance services to migrant labor, low income households, small businesses, other unorganized sector entities and other users by enabling high volume-low value transactions in deposits and payments/remittance services in a secured technology-driven environment.

In February 2015, RBI has received 72 applications for small finance banks and 41 for payments banks. On August 19th, 2015, the Reserve Bank of India decided to grant “in-principle” approval to 11 applicants to set up payments banks under the Guidelines for Licensing of Payments Banks issued on November 27, 2014.

The Micro Units Development Refinance Agency (MUDRA) Bank, is also a major recent development in the land of financial inclusion. The Bank will start as a department of the Small Industries Development Bank of India (SIDBI), and is conceived to facilitate the adoption of responsible finance principles by all lenders and in-turn help prevent issues of overleveraging of borrowers, and become a prominent source of funding and liquidity to Non-Banking Finance Companies- Microfinance Institutions (NBFC-MFIs) and other players in the sector.

The MUDRA bank would primarily be responsible for:

- Laying down policy guidelines for micro enterprise financing business;
- Registration of MFI entities;
- Supervision of MFI entities;
- Accreditation /rating of MFI entities;
- Laying down responsible financing practices to ward off over indebtedness and ensure proper client protection principles and methods of recovery;
- Development of standardized set of covenants governing last mile lending to micro enterprises;
- Promoting right technology solutions for the last mile;
- Formulating and running a Credit Guarantee scheme for providing guarantees to the loans/portfolios which are being extended to micro enterprises;
- Supporting development & promotional activities in the sector;
- Creating a good architecture of Last Mile Credit Delivery to micro businesses under the scheme of Pradhan Mantri MUDRA Yojana.

The Reserve Bank of India intends to remain a driving force for financial inclusion in India. On July 15th, 2015 RBI announced the constitution of a Committee with the objective of working out a medium-term (five year) measurable action plan for financial inclusion.
As per RBI’s publication, the key tasks of the Committee will be:

(i) To review the existing policy of financial inclusion including supportive payment system and customer protection framework taking into account the recommendations made by various committees set up earlier.

(ii) To study cross country experiences in financial inclusion to identify key learnings, particularly in the area of technology-based delivery models, that could inform our policies and practices.

(iii) To articulate the underlying policy and institutional framework, also covering consumer protection and financial literacy, as well as delivery mechanism of financial inclusion encompassing both households and small businesses, with particular emphasis on rural inclusion including group-based credit delivery mechanisms.

(iv) To suggest a monitorable medium-term action plan for financial inclusion in terms of its various components like payments, deposit, credit, social security transfers, pension and insurance.

6 Financial Inclusion Initiatives supported by the National Bank for Agriculture and Rural Development

The National Bank for Agriculture and Rural Development (NABARD) has also played an important role and is still fully involved in the financial inclusion movement. Among the initiatives led by NABARD can be mentioned the SHG-Bank Led Program. Recently updated guidelines “SHG 2” have been published by NABARD, including innovations meant to resolve the issues identified under the previous scheme:

- Inadequate outreach in many regions;
- Delays in opening of SHG accounts and disbursement of loans;
- Impounding of savings by banks as collateral;
- Non-approval of repeat loans even when the first loans were repaid promptly;
- Multiple membership and borrowings by SHG members within and outside SHGs;
- Limited banker interface and monitoring.

According to NABARD the model promoted by the SHG 2 guidelines focuses “on voluntary savings, cash credit as a preferred mode of lending, scope for multiple borrowings by SHG members in keeping with repaying capacity, avenues to meet higher credit requirements for livelihood creation, SHG Federations as non-financial intermediary, rating and audit of SHGs as part of risk mitigation system and strengthening monitoring mechanisms”.

The Women Self Help Group Scheme was proposed in the national budget 2011-2012. It is implemented across 150 backward districts of the country. The Scheme aims to have Self Help Promoting Institutes (SHPI) promoting and enabling credit linkage of these groups with banks, but also serving as a banking/business facilitator (including tracking, monitoring these groups and being responsible for loan repayments). It is managed by NABARD through two of its major microfinance funds, namely Financial Inclusion Fund (FIF) and the Financial Inclusion Technology Fund (FITF), created following the recommendations of the report of the 2008 Rangarajan Committee on Financial Inclusion.

Digitalize Self-Help Groups, the Eshakti Initiative. Keeping in view the Government of India’s mission for creating a digital India, NABARD launched a pilot project for the digitisation of all SHGs in 10 districts across 10 states of the country. To begin with, 2 districts Ramgarh (Jharkhand) and Dhule (Maharashtra) are being covered during the year 2014-15. The pilot is
to be executed over a 2 years’ period and is expected to cover 75,000 SHGs (1.1 million poor rural households).

The objective of this initiative is to support the GoI’s efforts towards financial inclusion, (i) integrating SHG members with the national Financial Inclusion agenda; (ii) improving the quality of interface between SHG members and Banks, (iii) facilitate convergence of delivery system with SHGs using the Aadhaar system and (iv) uplift the economic level of the SHG members, mostly poor rural women.

Among the benefits expected from this program is to bring SHG members on the digitalized Financial Inclusion map, enabling them to have access to wider range of financial services. The digitization of SHG accounts is expecting to increase bankers’ comfort in credit appraisal and linkage of SHGs with an automatic and accurate rating of SHGs being available online. The initiative is allowing mapping of persons not covered under Aadhaar platform and bringing them under Aadhaar fold. This should then ease the transfer of social benefits and Direct Benefit Transfer (DBT) through Aadhaar linked accounts and convergence with other Government benefits. The data collected should help in identifying suitable interventions and support for proper nurturing and strengthening of SHGs.

Information captured include (i) Member Level data (Name, address, gender, marital status, physically challenged status, Aadhaar details, Voter ID card details, mobile number, BPL/APL status, membership of Joint Liability Group (JLG), house type, availability of toilets, electricity connection and other financial details like saving bank account number, savings, borrowing & repayment, life/ medical insurance, micro pension policy), (ii) SHG level data (Name, address, date of formation, name of SHPI/NGO, name of supporting programme, saving habits, lending policy, bank linkage, details of periodic savings collected and internal lending, utilization of bank credit availed for members, and (iii) Output and MIS (Member wise details of SHGs about regular savings, lending and attendance, Financial Statement of SHGs Balance Sheet and Profit & Loss account, Rating report, Audit report, Bank linkage details savings and credit disbursement, etc.).

7 Financial Inclusion Initiatives supported by the Small Industries Development Bank of India

The Small Industries Development Bank of India (SIDBI) is also putting the financial inclusion as a key element of its initiatives in favor of Indian SMEs. Several schemes can be cited:
(i) Service Sector Assistance, “for Existing Small and Medium Service Sector Enterprises in need of Loan/Capital for Growth, and Existing promoters with experience in the similar activity for setting up new projects”; (ii) Flexible Assistance For Capital Expenditure, dedicated to “Existing MSME planning to Modernize, Upgrade Technology, Diversify by making large Investments in land/ building”; (iii) Receivable Finance Scheme, “to mitigate the receivables problem of suppliers belonging to Micro, Small and Medium Enterprises (MSMEs) and improve their cash flow/liquidity”; (iv) Loan Facilitation & Syndication Services for Entrepreneurs, under this initiative, SIDBI “facilitates Bank loans for new as well as existing manufacturing and service sector units”; (v) Growth Capital & Equity Assistance, provides assistance in form of Mezzanine/Convertible Instruments, Subordinated debt and Equity (in deserving cases) to small and medium business in need of capital for growth; (vi) Government Subsidy Schemes, to help MSMEs adopt modern technological processes and undertake capacity expansion; etc.
8 Conclusion

The GoI and all the actors of the financial sector need to take into account all aspects of financial inclusion. The increase of the number of accounts is not sufficient as a worrying proportion of them is dormant. Coordination should be improved among public and private actors, the latter being fully integrated in national schemes and policies. The depth of the financial sector should also be a matter of attention, as well as the sustainability of the financial inclusion results obtained so far. It is important to know if they rely only on the special schemes and measures implemented or if they will remain at this level overtime, or even progress further.

Indian authorities and financial inclusion actors lack measurement and knowledge of the outcomes and impact of the past and actual initiatives toward financial inclusion. It is commonly acknowledge than the shift in the financial inclusion efforts, as summarized in the Pradhan Mantri Jan-Dhan Yojana (PMJDY) policie and recent schemes like the DBT program, are a move in the right direction. However evidence are lacking to establish correlation or causality between specific policies and the financial situation in India, and to design the next phases of the financial inclusion efforts. An ambitious program of evaluation of these policies would highlight success and failures and help shape the next steps of financial inclusion support.
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